

BLOCK 1	OVERVIEW OF BUSINESS LAW	5
Unit 1	Introduction to Business Law	7
Unit 2	Concepts and Principles	22
BLOCK 2	BUSINESS FORMS AND LEGISLATIONS	37
Unit 3	The Partnership Act, 1932	39
Unit 4	The Companies Act, 2013	72
BLOCK 3	BUSINESS CONTRACTS	109
Unit 5	General Principles of Contracts	111
Unit 6	International Contracts of Sale	132
BLOCK 4	LEGAL AND REGULATORY FRAMEWORK FOR FINANCING AND INVESTMENTS OF BUSINESS	147
Unit 7	Banking and Other Allied Regulations	149
Unit 8	Foreign Exchange Management and Related Regulations	162
Unit 9	Insolvency and Bankruptcy	184
BLOCK 5	INTELLECTUAL PROPERTY AND DATA MANAGEMENT	203
Unit 10	Intellectual Property Rights	205
Unit 11	Data Protection and Privacy	224
BLOCK 6	BUSINESS AND SUSTAINABILITY	237
Unit 12	Environment Protection and Sustainability	239
Unit 13	Competition Law	257
Unit 14	Consumer Protection Law	273

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COURSE INTRODUCTION

The occupation of business plays an extremely important role in the economy of any country. The act of engaging in business, which consequently results in the creation of jobs and opportunities, along with the generation of revenues for the economic sector forms a significant part in nation building. The proliferation of business activities calls for a mechanism to regulate its conduct, and law facilitates this purpose. For strong and productive economies, the need to have an adequately enforced system of equally applied law has been increasingly felt. Law has become an important part of any business activity. A certain framework of law is necessary for maximum incentive to entrepreneurs, investors and inventors. Business law has taken an important place because it secures the elements of trust and certainty that are vital to economic transactions amongst strangers.

The scope of business laws is very vast. It takes into its ambit the laws related to all the activities proving indispensable for the successful conduct of the business. The scope of business laws is not restricted to the laws related to companies but it also provides laws for business activities conducted by other forms of business organisations. There are laws to deal with contracts, property, agency, negotiable instruments, sale of goods, bailment, guarantees, intellectual property, etc. In relation to companies, there is multitude of laws such as corporate laws, securities laws, competition law, foreign exchange laws, tax laws, etc. Right from the incorporation of a business entity till it attains finality, numerous laws are provided for every significant act that may be resorted to by a business entity throughout its life. Business laws also sub-serve the interests of society at large. Laws dealing with insurance, environmental protection, taxation, etc., are extremely beneficial for the promotion of rights and interests of the general public. Antitrust law, which also forms an important part of business law, keeps a check on market concentration, monopolistic and oligopolistic companies along with the dominance exerted by these companies in the market.

Therefore, understanding the basics of business law are extremely important for the students of business management stream to get a firm grasp on the concepts and gaining deeper knowledge of the subject.

The terms “Business law” and “Business Laws” are used interchangeably used in this material. “Business Law” is a generic or umbrella term which provides legal and regulatory framework for doing business. Business environment in any country is governed by its business laws that are necessary for conducting business transactions and regulate business.

Keeping this in view, the present course MMPC-013 on Business Law has been written. All important legislations and related concepts have been explained to familiarise the students and facilitate their easy understanding. This course has been prepared with following course outline to cover almost all important legislations and nuances of Business Law:

Block 1 : Overview of Business Law

Unit 1 : Introduction to Business Law

Unit 2 : Concepts and Principles

Block 2 : Business Forms and Legislations

Unit 3 : The Partnership Act, 1932

Unit 4 : The Companies Act, 2013

Block 3 : Business Contracts

Unit 5 : General Principles of Contracts

Unit 6 : International Contracts of Sale

Block 4 : Legal and Regulatory Framework for Financing and Investments of Business

Unit 7 : Banking and other Allied Regulations

Unit 8 : Foreign Exchange Management and Related Regulations

Unit 9 : Insolvency and Bankruptcy

Block 5 : Intellectual Property and Data Management

Unit 10 : Intellectual Property Rights

Unit 11 : Data Protection and Privacy

Block 6 : Business and Sustainability

Unit 12 : Environment Protection and Sustainability

Unit 13 : Competition Law

Unit 14 : Consumer Protection Law

BLOCK-1

OVERVIEW OF BUSINESS LAW

Unit 1 : Introduction to Business Law

Unit 2 : Concepts and Principles

UNIT 1 INTRODUCTION TO BUSINESS LAW

Objectives

After studying this unit you should be able to:

- Explain the concept of Business
- Understand the objectives, scope and significance of business law in the present business environment
- Describe the various sources through which business law has evolved

Structure

- 1.1 Introduction
- 1.2 Meaning of Business
- 1.3 Business Environment
- 1.4 Significance of Business Law
- 1.5 Objectives of Business Law
- 1.6 Scope of Business Law
- 1.7 Corporate Restructuring under Business Law
- 1.8 Sources of Business Law
- 1.9 Summary
- 1.10 Self-Assessment Questions
- 1.11 Further Readings/References

1.1 INTRODUCTION

The occupation of business plays an extremely important role in the economy of any country. The act of engaging in business, which consequently results in the creation of jobs and opportunities, along with the generation of revenues for the economic sector, forms a significant part in nation building. The proliferation of business activities calls for a mechanism to regulate its conduct, and law facilitates this purpose. For strong and productive economies, the need to have an adequately enforced system of equally applied law has been increasingly felt. Law has become an important part of any business activity. A certain framework of law is necessary for maximum incentive to entrepreneurs, investors and inventors. Business law has taken an important place because it secures the elements of trust and certainty that are vital to economic transactions amongst strangers. It also includes a study of legal compliances related to any business activity. In this Unit, there will be a discussion on the concept of ‘Business’ and the objectives of ‘Business Law’. The Unit will help in the understanding of the significance of business law in the present business environment and elaborate on the various sources of business law.

The terms “Business law” and “Business Laws” are used interchangeably in the text. “Business Law” is a generic or umbrella term which provides legal and regulatory framework for doing business. Business environment in any country

is governed by its business laws that are necessary for conducting business transactions and regulate business.

Understanding the basics of business law are extremely important for the students of business management stream to get a firm grasp on the concepts and gaining deeper knowledge of the subject. This Unit shall focus on defining the meaning of business, the scope and significance of business law in the current economic scenario, and to acknowledge the different sources of law which contributed in the evolution of business law.

Three concepts establish a necessary framework for the most effective functioning of market in the modern nation- **Law**, the **Rule of Law** and the **Property**.¹ The forces that hold societies together range from custom and religion to law and economic ties. In the modern nation, however, the most significant of the social forces is law because law can glue together diverse peoples of different backgrounds in to very large, organized groups. Law is known by everyone as being intended to tell members of society what they can and cannot do.²

Law:

It is necessary to have preliminary discussion on ‘what is law’ before students are introduced to ‘Business Law’. The term “law” has been defined in many ways. It is not easy to give a precise definition of law. It has been defined as rules of human action.³ A simple definition of law provides that law is a formal social force, is made up of rules which are laid down by the state and are backed by enforcement.⁴

Rule of Law:

Under the Rule of law, laws are made generally and equally applicable. They apply to all members of society and to various groups in the same way. In the words of Secretary General of United Nations, “without confidence based on the rule of law; without trust and transparency- there could be no well-functioning markets.”

“Without the rule of law, major economic institutions such as corporations, banks and trade unions would not function, and the government’s many involvements in the economy- regulatory mechanisms, tax systems, customs structure, monetary policy and the like- would be unfair, inefficient and opaque.”⁵

Property:

The term ‘property’ has two meanings, something that is owned and ownership. It is through the law of property that individuals and business organizations can possess, use and transfer their private resources. The property is a legal fence that keeps others out without your permission. The exclusionary right of property provides a basis for the private market and modern business. Property has been thought of as the central concept underlying Western Legal Systems.⁶ Contract law enables an owner to exchange resources at a future date, tort law compensates owners whose resources are wrongfully harmed by actions of others, criminal law punishes those who harm an owner’s resources in a particular way and the law of business organizations identifies how individuals can own and use private resources in groups. The below mentioned figure indicates the Wheel of Property.⁷

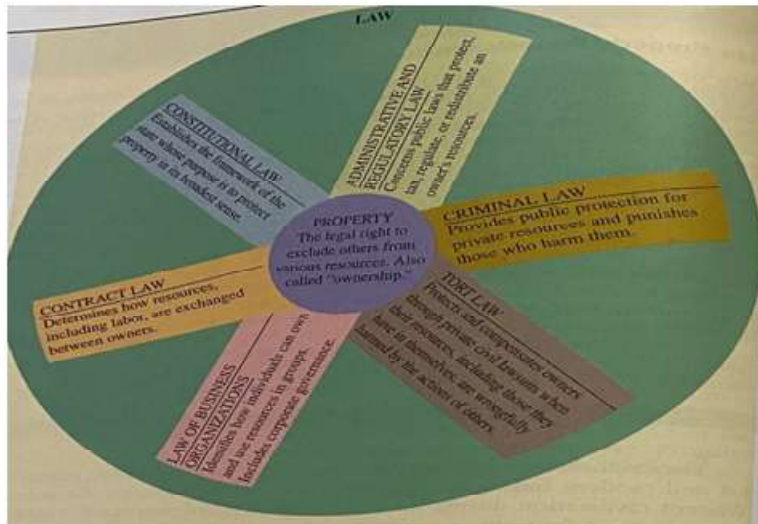


Figure .1.1: Wheel of Property

1.2 MEANING OF BUSINESS

A business can be defined as an enterprise or organization involved in an industrial, mercantile or commercial activity. A business entity may be brought forth for a profit purpose or it can serve non-profit purposes supporting a charitable or a social cause. A business may also be referred to the activities of an individual or a group of individuals engaged in the sale of goods and provision of services with a profit motive.

“The term ‘business’ may be understood as the organised efforts of enterprises to supply consumers with goods and services and to earn profit in the process. Business is a broad term and includes such varied activities as production, promotion, wholesaling, retailing, distribution, transportation, warehousing, financing, insurance, consultancy, and the like.”⁸ L.R. Dickson has defined ‘business’ as a form of activity pursued primarily with the object of earning profit for the benefit of those on whose behalf the activity is conducted.

“Businesses vary in size, as measured by the number of employees or by sales volume etc. But all businesses share one common purpose that is to earn profits. The purposes of business that goes beyond earning profits are -an important institution in society, for the supply of goods and services, creating job opportunities, offering better quality of life, contributing to the economic growth of the country, etc.”⁹

Business law, also commonly known as commercial or mercantile law, is that branch of law that conducts the relationship between the enterprises, companies and individuals engaged in commercial matters. This section of law governs issues in relation to the legal rights, duties and liabilities of the entities engaged in business transactions.

Business Law has attained a significant position in the current era, due to the formidable position held by the business enterprises and corporations in contributing to the economy and by the supply of abundant job positions boosting the employment sector, thereby contributing towards the generation of revenues. “Business law consists of the enforceable rules of conduct that govern commercial relationships. In other words, buyers and sellers interact in market exchanges

within the rules that indicate the boundaries of legal business behavior. Constitutions, legislatures, regulatory bodies, and courts spell out what market participants may or may not legally do. Understanding business law is necessary for future businesspeople because there simply is no market transaction that occurs outside legal guidelines. All contracts, employment decisions, and payments to a supplier are limited and protected by business law. Each of the six functional areas of business - management, production and transportation, marketing, research and development, accounting and finance, and human resource management - sits on a foundation of business law.”¹⁰

Business law is a body of legal rules regulating business activities. Business Law can also be defined as follows:

- 1) “Business law is that portion of the legal system which guarantees an orderly conduct of business affairs and the settlement of legitimate disputes in a just manner.”
- 2) “Business law establishes a set of rules and prescribes conduct that enables us to avoid misunderstandings and injury in our business relationships.”¹¹

1.3 BUSINESS ENVIRONMENT

The business environment consists of all those factors or forces which shape the conduct of business. Such factors may be categorized as internal and external factors. Internal factors included factors within the control of any business. External factors, on the other hand include factors that are beyond the powers or control of any business. Both internal and external factors keep on changing and are dynamic in nature. External factors also include laws, regulations and policies that affect the conduct of business. Figure -1.2 very clearly explains the characteristics of business environment in which businesses operate.

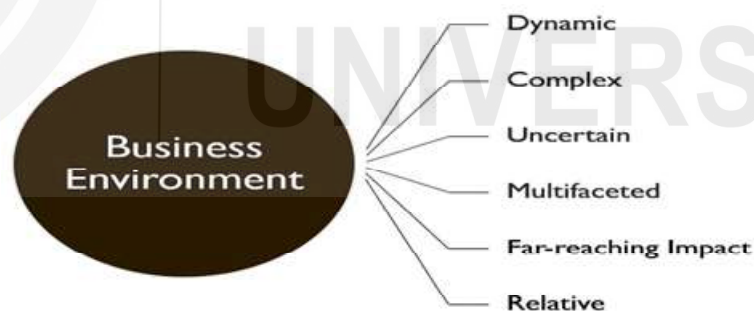


Figure-1.2¹²: Business Environment

1.4 SIGNIFICANCE OF BUSINESS LAW

Business law is that branch of the legal system which promotes an orderly treatment of business affairs, facilitates the regulation of commercial activities in accordance with established practices of law, and provides for settlement of disputes in an amicable manner. It constitutes that part of the legal system which is most fundamental to national wealth creation. It also specifies the rules and the conduct that needs to be adhered to, for the creation of successful business relationships among the government, business entities and the public, and business enterprises inter se. Business law also aids in establishing the environment needed

for responsible and peaceful business dealings not just amongst the different enterprises but also for safeguarding the rights of the employees. Business law also requires understanding and firm grounding of multiple substantive areas of law.

Business law has gained significance due to the changing business environment. Business environment is dynamic in nature and there is a requirement of having adequate laws in place to govern the business organisations functioning in the society.

1.5 OBJECTIVES OF BUSINESS LAW

We enter into contracts every day. Some of these contracts are made consciously, for example, for the purchase or sale of any goods, purchase of a share of a company or a plot of land. Entering into contracts determines the legal rights of each party giving rise to legal obligations as well. People who are engaged in business activities such as business owners enter into a contract on a daily basis to further the business transactions. All business activities include a variety of transactions which give rise to contracts on a daily basis. Some of these contracts are as simple as purchasing goods from a shop thus giving rise to a legal right and legal obligation.

Business law serves a variety of purposes some of which are listed below:

- i) **A comprehensive set of standards established universally:** Business laws are comprehensive and uniform set of standards that are applicable to all business entities. Uniformity in laws helps in maintaining smooth relations between the businesses and its various stakeholders including consumers, suppliers, etc. It provides an environment where the businesses can function smoothly and efficiently as the same rule shall be applicable to all the business organisations falling in a particular category. However, there can be different compliances for different kinds of business organisations depending upon the size, nature of business activity or certain threshold limits.

It also helps in identifying and establishing the rights and liabilities of the various parties interacting with each other. It provides a framework for reducing the harm caused to either party due to fraudulent or unethical activities. Business law also provides for steps that needs to be followed while conducting due diligence before engaging with a particular company.

- ii) **Promoting industrial growth:** Business laws not only provides different provisions for compliance for the business but also facilitate industrial growth by protecting and promoting the rights of businesses. Adherence to the rules prescribed by the range of laws falling under the domain of business facilitates businesses to achieve growth and success. Thus, business laws enable; capital formation, promote industrial relations, facilitation of licensing, ease of doing business, financial inclusion, etc. which promote economic growth.
- iii) **Laying down the procedure for the establishment of business:** The laws dealing with business provide the necessary framework required for the commencement of a business corporation along with building of a strong foundation for the business entity to thrive in the market. The formal process provided under the laws also facilitates successful conduct throughout the

life-cycle of the business. For instance, Companies Act, 2013 lays out the steps involved in the incorporation of a company, and provisions related to the Articles of Association and the Memorandum of Association in detail.

- iv) **Enforcement of Rights:** Business laws provide provisions for judicially enforcing the rights of all the parties involved in a business transaction. Thus, the businesses can approach the court to enforce the claims against the debtors or right to a patent or copyright or the right to hold property, etc. Businesses also have a right to defend themselves in case actions are filed by the central, state and local bodies. Thus, businesses have been given the power of initiating legal action in case any legal compliance are breached by any outside party and also allowed to defend themselves against the litigation filed by the government for the various stakeholders. Various provisions aiding in carrying out the enforcement action have been provided in statutes for effective regulation of the business practices.
- v) **Contributes to the building of healthy business relationships:** Laws dealing with business matters are extremely significant in the establishment of secure and effective business relationships amongst the concerned entities as the formation of strong business ties is an absolute must for building a strong economy of a country. For instance, the Partnership Act lists out the rights, duties, and obligations of the partners in a firm for carrying out a successful venture.

Business Law also plays an extremely important role in facilitating Mergers and Acquisitions (M&As) between enterprises looking to collaborate and expand their business. Cross-Border M&As transactions also contribute immensely to the economy of a country by playing a significant role in increasing the revenues generated through the means of Foreign Direct Investment. Cross border M&A occurs between companies situated in two different jurisdictions. If the resulting company is an Indian company, it qualifies as an inbound merger, and if the resulting company is a foreign company, it is christened as an outbound merger.

- vi) **Reduced possibilities of fraud:** A robust and effective business law framework helps in reducing the possibility of fraud as the parties entering into contracts or dealing with each other are well aware of their rights and liabilities which would prevent them in falling prey to the illegal or fraudulent activities by the other party. The laws associated with Business Law also provides for a highly effective enforcement mechanism, which are further lined with stringent measures that could minimize the possibility of perpetuating fraud.
- vii) **Business laws help maintain equilibrium:** Business laws help in bringing about uniformity and maintaining equilibrium as there are set rules which have to be followed by each entity. Different forms of business organisations are regulated by different laws. This helps in the ease of dealing and conducting business as the same standards are followed throughout the country. It helps in making the business transactions easier and smoother across the country.
- viii) **Ethical conduct:** Business laws also help in improving the conduct of the business as the laws have to be followed in letter and spirit. Therefore, the

business organisations have a responsibility of maintaining ethical conduct while functioning in the society. As businesses survive in the society and use its resources, there is a responsibility on the businesses to give back by dealing ethically with all its stakeholders.

For instance, the multi-billion-dollar scam orchestrated by the promoters of Satyam Computer Services, also referred to as “Satyam Scam”, made the regulators across the country re-examine the then-existing corporate governance standards and the fallacies therein. The scam resulted in the violation of multiple provisions of various statutes, such as, Companies Act, 1956 (Sections 209, 233 and 628), Securities (Contract) Regulation Act 1956 (Sections 23A, 23E), SEBI Act (Sections 15HA and 24, and Criminal law. Under the Companies Act, 1956, the resulting violations included failure to maintain proper books of account, penalty for false statements and non-compliance of auditor duties. However, after this incident, sweeping changes were brought forth in the Companies Act, 2013 to combat any unforeseen deviations that may be resorted by the corporate enterprises. The new Companies Act, 2013 mandated at least one-third of the Board to be comprised of Independent Directors, and that they shall not be eligible to receive any stock options and be remunerated only in fee. The new Act also imposed strict norms on any related party transactions along with providing for class action suit options against the company and auditors, for protecting minority shareholders’ interests. It also brought forth provisions clearly defined demarcating the accountability of auditors.

- ix) **Social Responsibility:** Business laws also lay down the criteria for business to function in a society as the business utilize the resources of the society there arises a responsibility of the business to give back to the various stakeholders. This enables social justice and social responsibility in the form of good employment practices, non-discrimination, sustainable utilization of resources, prevention of environmental damage etc. Thus, it prohibits businesses from entering into practices that are harmful to the society at large.
- x) **Laying down law in accordance with the evolving standards:** The business environment is ever-changing and dynamic in nature. The laws have to be enacted taking into account the economic and business environment of the country. These laws not only provide uniformity in business operations but also provide clarity to unforeseen situations. Legislative changes in the form of amendments are made to address the occurrence of unforeseen situations.

An example for this would be the Indian Competition Act, which handles and regulates antitrust issues in the country. The Competition Act, 2002 is concerned with keeping a check on the prevailing anti-competitive acts in the relevant market being governed. The Act encompasses horizontal and vertical agreements, cases related to abuse of dominance, and regulation of combinations. It must be noted that until now Competition Act only focused on price parameters such as unreasonable increase in prices or reduced output in the supply of the goods. However, the advent of digital technology has ushered an era demanding a change in the traditional methods employed to gauge anti-competitive practices. The Indian Competition regulatory authorities have also initiated investigation into degradation of non-price

parameters such as quality, privacy and innovation keeping pace with the changing needs of the society in an era of online platform markets. The Competition Commission of India, which until recently investigated anti-competitive conduct solely based on monetary price increase, has acknowledged the importance of data as a currency in the current business scenario and initiated investigation against data monopolies.

- xi) Providing penalties for violation of laws:** Business law serves an extremely important purpose of enlisting the various penalties that may be employed by the regulatory bodies to ensure that the conduct of business activities conforms to the prescribed standards set by the concerned branch of law. The legislations dealing with the various aspects of the business have provided the penalties that may be incurred by the wrongdoers on contravention of the law and the rules provided therein. For instance, chapter VI under the Competition Act, provides for various penalties for contravention of the orders of the Commission or for non-compliance of the directions of the Director-general or the Commission. Similarly, Chapter VII of the Insolvency and Bankruptcy code (IBC) provides for punishment of offences, penalties for acts including falsification of books of corporate debtor, false representations to creditors and transactions for defrauding creditors, etc.
- xii) Insurance against Risks:** Every business involves inherent risks that may be related to operations of business, movement or transit of goods, and financial risks, etc. Insurance laws provide mechanisms for insuring against such unforeseen circumstances for the business. Directors and officers of the companies can also take D & O insurance policies for protection against future liabilities.

1.6 SCOPE OF BUSINESS LAW

For a better understanding of business laws and the scenario giving rise to their emergence, it is imperative to understand the frame of societal reference which gave birth to this branch of law. Any study of business law must necessarily provide major thrust to the rules framed in relation to business law, because “society has imposed constructive notice of that law.”¹³ Understanding the background sheds light on the reason behind the emergence and the functioning of a particular law and shall aid in making policies that might prove beneficial in the long run.

The scope of business laws is very vast. It takes into its ambit the laws related to all the activities proving indispensable for the successful conduct of the business. The scope of business laws is not restricted to the laws related to companies but it also provides laws for business activities conducted by other forms of business organisations. There are laws to deal with contracts, property, agency, negotiable instruments, sale of goods, bailment, guarantees, intellectual property, etc. In relation to companies, there is multitude of laws such as corporate laws, securities laws, competition law, foreign exchange laws, tax laws, etc. Right from the incorporation of a business entity till it attains finality, numerous laws are provided for every significant act that may be resorted to by a business entity throughout its life. There are a range of laws that have been enacted for the proper commencement of business activities, for the required conduct during its life

cycle, with finally laws laying down procedures directing the regulation and culmination of the business activity in question. Business law also aids in raising questions against governmental regulations in case it results in violation of legitimate business practices. The legal consequences of the multifarious business transactions also play a significant role for the accountant of the company in auditing the company's books and in the course of preparing required financial statements. Business laws also subserve the interests of society at large. Laws dealing with insurance, environmental protection, taxation etc., are extremely beneficial for the promotion of rights and interests of the general public. Antitrust law, which also forms an important part of business law, keeps a check on market concentration, monopolistic and oligopolistic companies along with the dominance exerted by these companies in the market.

Government also facilitates business transactions wherever it is required in the best interests of the company. The Government had invited bids for the Air India divestment process, for which the Tata Group and Spice Jet promoters have submitted bids. The Government has decided to offer hundred percent stake in the debt-ridden state-run airline this time. This has been done after Air India had failed to attract any bidder when the government had offered a 76 percent stake in the former three years ago.¹⁴

1.7 CORPORATE RESTRUCTURING UNDER BUSINESS LAW

Corporate restructuring also forms an essential part of the business development. Corporate restructuring is a process whereby a firm looks to enhance its shareholder value. It encompasses a broad range of transactions within its ambit, including within its purview, changing its capital structure through the infusion of high levels of debt to selling-off business lines or making acquisitions by taking over corporations and making internal changes in the organization of the firm. It is an absolute necessity for a company's basic survival or sustenance in the corporate sector to combat multiple competitors in the market looking to dominate¹⁵. There are numerous ways by which a company may look to restructure its business – viz., merger and amalgamation, merger through absorption, merger through consolidation, acquisition, takeovers, divestiture, demerger, joint venture, and buyback of securities, to name a few. There can exist multiple reasons for a company to opt for internal or external restructuring such as, to focus on core competency, for hiving-off assets, eliminating competition, achieving economies of scope and economies of scale, gaining access to R&D and technology knowhow, synergistic effects, diversification and enhancing public perception. These different forms of restructuring are also supervised by different branches of business law, such as Companies Act, FEMA, Taxation laws, SEBI Act to name a few.

One recent example of a company engaging in restructuring, in the form of acquisition as a means to expand could be the case of Ed-tech giant Byju's, which is looking to achieve success in K-12 (Kindergarten to 12th standard) online education. Byju's has already engaged in multiple acquisitions including medical coaching Institute Aakash, Epic games, Great Learning, Scholr, Gradeup, to name a few spending close to \$2 billion for the same in this year. Byju's has recently made its ninth acquisition of the year when it acquired Tynker, a silicon-valley based coding platform for children, for an estimated amount of \$100 million,

also its third acquisition of a US-based company. These slew of acquisitions by the company have been made with a view to obtain a public listing in the US. The phenomenon of M&A is governed by legislations such as, Companies Act, SEBI Act and its Substantial Acquisition of Shares and Takeover (SAST) regulations among others.¹⁶

Most of the current dialogues about corporate governance can also be attributed to discussing a corporation's existence and for whose interests the corporate exists and ultimately serves. Most commonly, the obvious answer is the maximization of wealth for the shareholders of a company. The principle of shareholder wealth focuses on the aspect of cash flows that may not be immediate profit-generating and more of a future outcome. A company aims to amplify the residual profits that remain after all the incidental costs are reduced. Profit generation may not be the only aim of a company, but it may prove to be a significant reason. From a shareholder perspective, in a competitive and flourishing market, anything a company does to enhance share prices is a plus. Moreover, whenever a shareholder does any activities, such as selling, buying, or retaining their shares, it adds to their value.

1.8 SOURCES OF BUSINESS LAW

There are many sources from which the business law evolves. Some of these main sources are:

i) **Constitution:**

The text of the Constitution along with its interpretation by the Supreme Court from time to time, is considered as the supreme law of the land. All laws and authority flowing from and traceable to the Constitution are recognised as lawful power. The Indian Constitution establishes the fundamental principles and rules by which the individual States are governed. The term constitutional law refers to the general limits and powers of the Central and State governments as stated in written constitutions. The Indian Constitution is the supreme law of the land, and all the laws of the country have their foundation in the Indian Constitution.

The Indian Constitution was drafted with certain objectives that were latent in the text and provided directions to the State to achieve a social order for the upliftment and welfare of the people. Even otherwise, post the 42nd amendment, the Preamble of the Constitution was incorporated with the terms "Socialist" and "Secular", which strengthened the objective to promote social welfare. Article 38 places the responsibility on the State to strive to promote the welfare of the people by achieving a social order, while Article 39 provides for a few principles of policy to be observed by the State. Article 38 and 39, though having been placed in part IV of the Constitution as Directive Principles of State Policy, and cannot be enforced in a Court of Law, prove extremely significant laying down directions for good governance of a State. Especially, it directs the State to frame policies that ensure that the ownership and control of the material resources are adequately distributed, and that the operation of the economic system must not lead to a concentration of wealth to the common detriment. For instance, the Government of India ordered the formation of a committee (Mahalanobis Committee) to assess the income distribution in the society due to the rising monopolistic and

restrictive trade practices that were being observed in the Country. This led to the formation of the Monopolies Inquiry Committee and the report submitted paved the way for the Monopolies and Restrictive Trade commission Act (MRTP Act). This way, the Constitution of India, specifically Article 39 sowed the seeds for the genesis of competition laws in India.

Article 19 (1) (g) of the Constitution guarantees that all citizens shall have the right to practice any profession, or to carry on occupation, trade or business. The right to carry on a profession, trade or business is not absolute. Reasonable restrictions can be imposed by the state in the exercise of such right. Part XIII of the Constitution deals with Trade, Commerce and Intercourse within the territory of India. Article 301 provides that subject to the other provisions of this Part, trade, commerce and intercourse throughout the territory of India shall be free. Article 302 gives power to the Parliament to impose restrictions. It says that the Parliament may by law impose such restrictions on the freedom of trade, commerce or intercourse between one State and another or within any part of the territory of India as may be required in the public interest.

ii) Statutes:

A Statute can be defined as an act of the legislature in written form. “Legislative actions, called *statutes*, are another important source of law. The assortment of rules and regulations put forth by Legislatures is what we call statutory law.”¹⁷ The Parliament and the State Legislatures have been conferred the primary responsibility to enact laws as per the requirements of the Union and the State respectively. “Legislation is the common source of law. Both Parliament and State assemblies have enacted a number of legislations that cover various aspects of business.”¹⁸

The act of creating laws, also known as legislating, cannot solely be performed by the Parliament, due to the enormous number of legislations required to run a State. The act of legislations can be delegated to subordinate authorities such as executive bodies and individuals, by providing the necessary guidelines, policies and rules that must be resorted to while laying down the law. This area of legislations is also known as delegated or subordinate legislation. The Legislature has come up with various laws to counter the issues cropping up in the business administration in our country.

iii) Cases:

Case laws play an important role in shaping the law and bringing out its relevance as per the prevailing conditions in the society. The interpretation offered by the judges in the form of *ratio decidendi* aids in clarifying the nuances of the law. Judicial decisions, in the form of precedents, are one of the most important sources of law. Case laws, Constitution, legislatures, and administrative agencies encourage certain behavior and prevent other actions. But the boundaries of these laws are seldom self-explanatory. Consequently, law must be interpreted. Case law is the collection of legal interpretations made by judges. An alternative name for case law is common law as common law is a judge made law. Interpretations provided by courts in cases are law unless they are revoked later by new statutory law. Case law is especially significant for businesses because a modern business often operates in multiple legal jurisdictions. Because statutory laws are subject

to interpretation, one court may have interpreted laws one way at one business location, and a second court may interpret a similarly worded statute differently at a second business location. Courts issue judicial decisions that often include interpretations of statutes and administrative regulations. These decisions contain the reasoning the courts use to arrive at their decisions. The reasoning depends heavily on precedent, the use of past decisions to guide future decisions. An earlier decision in a similar fact pattern is a precedent that guides later decisions, thereby providing greater stability and predictability to the law.”¹⁹

iv) Custom:

Custom is one of the most important sources of law. It is possible to detect two basic elements in the make-up of the custom - **material facts**, which is the actual behavior of states founded upon the performance of the state activities and practices; **psychological element**, which is the belief by the state that behaved in a certain way that it was a legal obligation to act that way. There are a number of factors concerning the nature of a particular practice – Duration, repetition, consistency and generality. “A substantial part of business law is customary, notwithstanding advances made in science and technology. This is true both in developed and developing countries. A custom, when accepted by courts and incorporated in judicial interpretations, becomes a law. Many of the business customs or usages have already been adopted and legalized. The Indian Contract Act provides that nothing therein contained, “shall affect any usage or custom of trade.” Similarly, the Negotiable Instruments Act provides that nothing there-in contained “shall affect any local usage relating to instruments in an oriental language.”²⁰

v) Treaties:

Treaties are a source of international business law. They are one of the sources that have been mentioned under Article 38 of the Statute of the International Court of Justice. Treaties are obligatory in nature and are founded upon the customary principle that agreements are binding upon the parties and must be performed in good faith. For many writers, treaties constitute most important source as they require the express consent of the contracting states, they are thus considered superior to custom. The consent to a treaty can be signified by signature, exchange of instruments, ratification or accession by the concerned countries. “The purpose of international laws is to permit countries as much authority as possible over their own international business affairs, while maximizing economic benefits of trade and working relationships with other nations. Since many countries have historically allowed governance by international agreements when conducting global business, there exists an evolving body of international laws that facilitate global trade and commerce.”²¹ “A treaty is similar to a contract in two important ways. Both treaties and contracts are attempts by parties to determine rights and obligations among themselves. In addition, when a party fails to obey a treaty or an international contract, international law imposes liability on that party.”²² Treaties can be **multilateral** – signed amongst many countries, and **bilateral** – existing between two countries.

vi) Government Policies:

The legal power to make laws comes to the government from the Constitution. Laws are framed according to the policies of the government. One can

understand the focus of any government through its policies. For example, when the focus is to promote ease of doing business, the government accordingly brought new legislations and regulated to remove bottlenecks which had increased time consumed in contracts enforcement. Similarly, the economic reforms undertaken, provision of easy financing for MSME sector or women entrepreneurs, bringing new policies like e-commerce policy, etc., are examples of government intervention for regulating the business through policies. Laws are made according to the policies.

1.9 SUMMARY

Understanding the basics of business law are extremely important for the students of business management stream to get a firm grasp on the concepts and gaining deeper knowledge of the subject. This Unit focuses on defining the meaning of business, the scope and significance of business law in the current economic scenario, and to explain the different sources of law which contributed in the evolution of business law.

A business can be defined as an enterprise or organization involved in an industrial, mercantile or commercial activity. A business entity may be brought forth for a profit purpose or it can serve non-profit purposes supporting a charitable or a social cause. A business may also be referred to the activities of an individual or a group of individuals engaged in the sale of goods and provision of services with a profit motive.

Business law is that branch of the legal system which promotes an orderly treatment of business affairs, facilitates the regulation of commercial activities in accordance with established practices of law, and provides for settlement of disputes in an amicable manner. It constitutes that part of the legal system which is most fundamental to national wealth creation. It also specifies the rules and the conduct that needs to be adhered to, for the creation of successful business relationships among the government, business entities and the public, and business enterprises inter se. Business law also aids in establishing the environment needed for responsible and peaceful business dealings not just amongst the different enterprises but also for safeguarding the rights of the employees. Business law also requires understanding and firm grounding of multiple substantive areas of law.

There are many sources from which the business law evolves. Some of these main sources are: Constitution, Statutes, Cases, Custom, Treaties, and Government Policies.

1.9 SELF ASSESSMENT QUESTIONS

- 1) What do you understand by the term “Business”? Elaborate.
- 2) What is the significance of business law in governing the functioning of the business enterprises and companies in the society?
- 3) Explain out the different sources of business law and their significance in the growth of business law.
- 4) Briefly explain the meaning of the term “corporate restructuring”.

- 5) Which Article in the Indian Constitution promotes the idea of framing policies to ensure that the operation of the economic system does not result in the concentration of wealth in the society?

1.10 FURTHER READINGS/REFERENCES

Weblinks:

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- ¹¹ *Supra* note 1, at 3
- ¹² *Understanding The Importance of International Business Law*, <https://elforeingoffice.com/understanding-the-importance-of-international-business-law/> (Last visited on May 11, 2021)
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- ¹⁵ Kenneth Lehn, *Public Policy Towards Corporate Restructuring*, 25(2) Business Economics. 26, 26-31 (1990)
- ¹⁶ Chandra R Srikanth, *Byju's buys US-based coding platform Tynker, its 9th acquisition this year*, (Sept., 16, 2021) <https://www.moneycontrol.com/news/business/startup/byjus-buys-us-based-coding-platform-tynker-its-9th->

¹⁷ *Supra* note 3, at 4

¹⁸ *Supra* note 1, at 6

¹⁹ *Supra* note 3, at 5

²⁰ *Supra* note 1, at 6

²¹ Valbrune Miranda and Assis Renee De, BUSINESS LAW 1 ESSENTIALS (OpenStax 2019), <https://openstax.org/books/business-law-i-essentials/pages/1-introduction> (Last Visited on 12/05/2021)

²² *Supra* note 3, at 7



UNIT 2 CONCEPTS AND PRINCIPLES

Objectives

The objectives of this unit are to:

- Understand important concepts under Business law
- Appreciate various principles under Business law
- Explain the statutes that fall under Business law in India
- Discuss the methods for dispute resolutions including Alternate Dispute Resolution (ADR)

Structure

- 2.1 Introduction
- 2.2 Concepts under Business Law
- 2.3 Principles of Business Law
- 2.4 Statutes under Business Law
- 2.5 Basic Scheme of Litigation- Resolution through Courts
- 2.6 Alternative Dispute Resolution
- 2.7 Summary
- 2.8 Self Assessment Questions
- 2.9 Further Readings/References

2.1 INTRODUCTION

Law has become an important part of any business activity. Business law has taken an important place in the legal study. Business law provides legal and regulatory framework for doing business. It includes study of legal compliances related to any business activity. This Unit will elaborate the concepts that fall under the business law. It will discuss the various principles of business law and the statutes that fall under business laws in India. The Unit also examines the dispute resolution mechanisms for resolving business disputes including the Alternate Dispute Resolution mechanisms.

Business Law incorporates into its ambit the set of laws that directs the process of formation and continuance of business, setting forth the laws which establish the rules that the companies and enterprises follow. “All legitimate businesses need to operate within the framework of the law. It is essential for persons working within the business world to have an understanding of how law works and affects their businesses, for example a contract will only be of value to a business if it is legally enforceable. The law sets down rules for the setting up and administration of certain types of business and governs areas of employment of staff. Although specialist legal advice is usually obtained on specific legal issues, it is essential to understand the core principles of business law.”¹

The enactment of laws and their staunch governance is of utmost importance in a country. “Laws are rules and regulations which govern the activities of persons within a country. They provide necessary rules, and balance the various interests

of different members of the community. Both natural persons (human beings) and legal persons (companies) are bound by laws of the country they reside in. From these laws they can ascertain what they are permitted to do and what they are not permitted to do.”²

2.2 CONCEPTS UNDER BUSINESS LAW

Any business begins with the basic understanding of what has to be done under any particular business and in what form it has to be done. A business may be established for production, manufacturing, provision of service or sale or purchase of products. Every such objective involves a complex set of contracts, transactions and payments. Similarly, in what form business has to be done requires deliberation about the type of business organization through which the business will be conducted. The types of business organizations would begin from sole proprietorship in which an individual carries the business followed by traditional partnerships, limited liability partnerships and incorporation of a company. Doing business in Hindu Undivided Family (HUF) is also prevalent in India in which male members of the family become *coparceners* in the business by birth in the family. The business is conducted by the *Karta* of the family. Therefore, the following concepts become important for any entrepreneur to understand:

- 1) Whether the business involves sale and purchase? If yes, basic concepts relating to contracts of sale should be well known.
- 2) Whether the business involves production or manufacturing? If yes, basic concepts relating to the contracts, intellectual property, product liability, contractual and tortious liability, should be known.
- 3) Whether the business involves formation of a partnership? If yes, depending upon the type of partnership, the process of formation and forthcoming liabilities of all partners should be very well known. In traditional partnerships, registration is not mandatory but has serious consequences in reducing remedies for the partnership against third parties. Partnership deed is advisable to be prepared as such partnerships have unlimited liabilities of partners. Limited Liability Partnerships (LLPs) provide opportunity to enjoy the benefit of partnership with limited liability of partners through incorporation of LLPs.
- 4) Whether the business involves incorporation of a company? If yes, which type of company will be suitable for the business should be understood. Generally, a limited liability company should be constituted for business involving capital and financial risks.

Rights and liabilities of shareholders of companies should be well understood for both private and public limited liability companies.

- 5) Whether the business is capital intensive? If yes, it should be known how the capital would be raised through public issues or borrowing.
- 6) Whether payments are required to be made? Generally, all businesses would require payments to be made to different persons. Basic knowledge about the concepts of negotiable instruments is required.

- 7) Every business involves different types of risks. Concepts relating to the insurance and risk management should be known and accordingly risks should be insured through proper insurance policies.
- 8) Disputes are also part and parcel of doing any business. Concepts relating to the rights, remedies, dispute resolution including alternative dispute resolution mechanisms should be well understood.
- 9) Legal and regulatory compliances should be properly adhered to by all businesses. For example, if business makes profits, how to comply with tax liability, if business involves off shore transactions how the tax liability should be covered becomes important for any business.

2.3 PRINCIPLES OF BUSINESS LAW

- 1) **Law and Morality:** “The Natural Law School of jurisprudence postulates that the law is based on what is “correct.” Natural law philosophers emphasize a moral theory of law—that is, law should be based on morality and ethics. Natural law is “discovered” by humans through the use of reason and choosing between good and evil.”³ “The very efficiency of the legal system depends on the moral attitude towards the notion of legality, since conformity with the law is not, in itself, a legal matter, but a moral obligation. Every law can be, and should be, evaluated from a moral viewpoint. The law cannot and must not regulate every aspect and each moment of our lives. Most often the law tells us how to proceed, but not what we should do.”⁴ Thus, businesses also have moral obligations and the business law acts as a guiding force to fulfill these moral obligations. Morality is achieved by following the law not only in letter but also in spirit.
- 2) **Business Ethics:** Business being part of the society has an assortment of responsibilities. Businesses have a relationship with the other parts of the community such as consumers, workers, vendors, marketers, etc. Businesses owe responsibility towards these parties of the community. The degree of responsibility may vary from business to business or stakeholder to stakeholder. Responsibilities are of diverse nature such as safe working conditions for the employees, good quality products, profit maximization for the shareholders, and sustainable use of the society’s resources. “Ethics is the study and practice of decisions about what is good or right. Ethics guides us when we are wondering what we should be doing in a particular situation. Business ethics is the application of ethics to the special problems and opportunities business people experience. An ethical dilemma is a problem about what a firm should do for which no clear, right decision is available. At the same time the business ethics guides decisions within firms, ethics helps guide the law. Law and business ethics serve as an interactive system—informing and assessing each other. The principles of contract law, for instance, facilitate market exchanges and trade because the parties to an exchange can count on the enforceability of agreements. Legal rules that govern the exchange have been shaped in large part by our sense of commercial ethics.”⁵

“The law dictates how a person *must* behave. Any choice about how a person should behave that is based on a sense of right and wrong is an ethics decision. Laws represent society’s view of basic ethics rules. And most people agree that certain activities such as murder, assault, and fraud are wrong. However,

laws may permit behavior that some feel is wrong, and it may criminalize acts that some feel are right.”⁶ Similar situations arise under business law for example, Factories Act, 1948 permits employment of children above 14 years of age, this may be wrong for some people however, it has been permitted under the law to allow them to earn a living according to the provisions set out in the law.

- 3) **Common Law:** Common law has been a major source of developing business law. Earlier commercial law was not regulated through specific statutes rather the principles of equity and justice were adopted in the common law approach, where precedents acted as a guiding force. Thus, common law still plays a very important role in the evolution and enactment of commercial law. “The term common law has several different meanings. It is usually used to mean the law that is not the result of legislation but is the law created by the decisions of the judges. When common law is given this meaning, it encompasses cases that have used both, or either, equity and common law.”⁷ “English common law was law developed by judges who issued their opinions when deciding cases. The principles announced in these cases became *precedent* for later judges deciding similar cases. The English common law can be divided into cases decided by the *law courts*, *equity courts*, and *merchant courts*.”⁸

“The common law is a beautiful system, containing the wisdom and experiences of ages. Like the people it ruled and protected, it was simple and crude in its infancy and became enlarged, improved, and polished as the nation advanced in civilization, virtue, and intelligence. Adapting itself to the conditions and circumstances of the people and relying upon them for its administration, it necessarily improved as the condition of the people was elevated. The inhabitants of this country always claimed the common law as their birth right, and at an early period established it as the basis of their jurisprudence.”⁹

- 4) **Natural Law:** “The term ‘natural law’ refers to the idea that there are certain ethical laws and principles that are morally right and above the laws devised by humans. This concept suggests that individuals should have the freedom to disobey a law enacted by a majority of people if their individual conscience goes against the law and they believe the law is wrong. The idea that people have basic human rights, for example, is rooted in the concept of natural law.”¹⁰ “The Natural Law School of jurisprudence postulates that the law is based on what is “correct.” Natural law philosophers emphasize a moral theory of law—that is, law should be based on morality and ethics. Natural law is discovered by humans through the use of reason and choosing between good and evil.”¹¹

“The law must have a moral basis. Where do we find the moral basis that would justify a law? Aquinas says that “good is that which all things seek after.” Therefore, the fundamental rule of all laws is that “good is to be done and promoted, and evil is to be avoided.” This sounds appealing, but also vague. Exactly which laws promote good and which do not? Is it better to have a huge corporation dominate a market or many smaller companies competing? Did the huge company get that way by being better than its competitors?”¹²

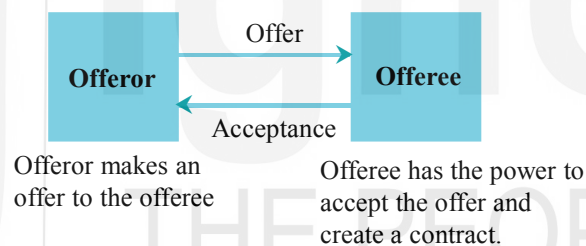
There can be numerous examples of the natural law theory to business laws, as business laws have evolved over time through customs and general usages

which were considered as the rules of the trade. These rules were based on ethical conduct, equity and fairness which has been ingrained in the laws by the law making bodies.

- 5) **Contractual Principles:** Salmon has defined a contract as an agreement that creates and defines obligation between the parties. Section 2(h) of the Indian Contracts Act, 1872 defines the term contract as an agreement enforceable by law. This also means that a contract is fundamentally an agreement having the power to legally bind the parties.

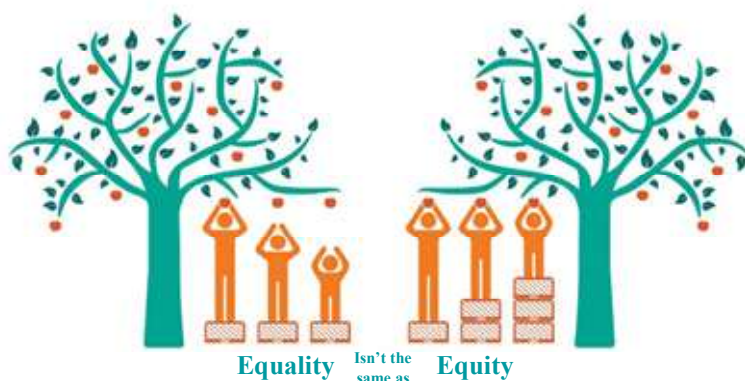
“A contract is an agreement that is enforceable by a court of law or equity. Every contract involves at least two parties. The offer or is the party who makes an offer to enter into a contract. The offeree is the party to whom the offer is made. In making an offer, the offer or promises to do—or to refrain from doing—something. The offeree then has the power to create a contract by accepting the offeror’s offer. A contract is created if the offer is accepted. No contract is created if the offer is not accepted.”¹³

All business laws have an element of contractual relationships which are governed as per the law. The Indian Contracts Act specifies the essentials of a valid contract also stating the various provisions that govern its enforceability. Simple transactions such as purchase of goods and services is a contract which attracts various statutes under the business law.



¹⁴Figure 2.1

- 6) **Equity and Fairness:** Equity and fairness is an important principle of business law. The provisions under business seek to provide equitable treatment to all. There are laws which vary according to the size of the business organization or the nature of business activity thereby differentiating between the business and the laws applicable to them. One such example can be the provisions of Corporate Social Responsibility where the amount of contribution by the companies is divided by thresholds on the basis of turnover, net worth or net profit thereby putting more responsibility on the bigger companies.



¹⁵Figure 2.2

2.4 STATUTES UNDER BUSINESS LAW

There are various enactments brought forth by the legislature which provide guidance for the carrying out business activities, along with their procedure, regulation and enforcement. Some of the legislations are listed below:

1) **INDIAN CONTRACTS ACT, 1872:**

A Contract is an agreement enforceable by law. The formation of Contracts plays an important role in business world and the law of contracts in India is governed by the Indian Contract Act, 1872. This law has its origins in the English common law. The drafting and formation of business contracts plays an extremely important role in paving the way for business entities to establish business relationships. The Contract Act also encompasses provisions related to the laws of agency, bailment, guarantee and indemnity.

2) **SALES OF GOODS ACT, 1930:**

The Sale of Goods Act, 1930, is an enactment to define and amend the law associated with the sale of goods. Earlier falling within the purview of chapter VII of the Indian Contracts Act, the principles of sale of goods came to be regulated under a separate act eventually. This Act performs the function of protecting the rights of buyers and sellers, laying down rules for transfer of ownership of goods, along with creation of remedies for an effective enforcement. The enactment also contains provisions for the principle of *caveat emptor*.

3) **NEGOTIABLE INSTRUMENTS ACT, 1881:**

Financial System encompasses credit as well as cash transactions. All transactions under the wing of finance are either dealt with cash payments or by issuance of negotiable instruments such as; Bills of Exchange, Cheques or Hundies, to name a few. The Negotiable Instruments Act, 1881, is an Act to define and modify the law relating to promissory notes, bills of exchange and cheques. This enactment also ensures that obligations that are assumed by the issuance of cheques as a mode of deferred payment are honoured.

4) **INDIAN PARTNERSHIP ACT, 1932:**

The Partnership Act governs the relation between persons engaged in a business who have decided to share the profits of a business undertaken by all or any one person on behalf of all. Partnership Act is also one amongst the bundle of laws, playing an important role in regulating business relations.

5) **LIMITED LIABILITY PARTNERSHIP ACT, 2008:**

This Act lays down provisions for the creation and regulation of Limited Liability Partnerships (LLPs), and provides the flexibility and dual benefits associated with partnerships and companies. LLP is an alternative corporate body form to conventional partnership firms, where a partner's liabilities are confined to their respective investments in the business. The Limited Liability Partnerships (Amendment) Bill, 2021 was passed by the Lok Sabha on August 09, 2021 and seeks to amend the prior Act. The new Act seeks to introduce certain changes providing for compounding of offences, decriminalizing certain offences and empowering the central government to direct an LLP to change its name on certain grounds.

6) COMPANIES ACT, 2013:

Though the legal system facilitates the formation of different business organizations, a company or a corporation is the most preferred vehicle to perform industrial and commercial activities. The Companies Act, 2013 was enacted to consolidate and amend the law associated with companies. The provisions of this Act shall be applicable to every company formed under the present or the previous Act (Companies Act, 1956). This enactment shall also apply to insurance companies, banking companies, companies engaged in the electricity generation, etc. The Act also provides for provisions in reference to corporate social responsibility. Companies Act also lays down the procedure to be followed by the companies willing to go for a restructuring in the form of mergers, amalgamation or demergers.

7) EMPLOYMENT AND LABOUR LAW:

Employment law comprises of laws and rules that aid in the enforcement, regulation and governing employer-employee relationships. With a view to consolidate the different legislations dealing with labour employment, industrial disputes, wages and other employment concerned matters, this branch of law which was traditionally governed by contract and numerous other legislations, the Government in 2019, brought forth four bills. They are - The Code of Wages, 2019; The Industrial Relation Code, 2020, The Occupational Safety, Health and Working Conditions Code, 2020; and The Code of Social Security, 2020. Employment and Labour Laws form an important part of the business practices being followed by the companies and enterprises and contributes in maintaining a healthy relationship between the employers and the employees.

8) TAX LAWS:

The financial obligations, in the form of taxes, that are levied on income, capital gains, sales, property etc., by the State Government, Central Government and also by local authorities, such as municipality is involuntary in nature. "While direct taxes are levied on taxable income earned by individuals and corporate entities, the burden to deposit taxes is on the assessee themselves. On the other hand, indirect taxes, such as Goods and Services Tax (GST) are levied on the sale and provision of goods and services respectively and the burden to collect and deposit taxes is on the sellers instead of the assessee directly."¹⁶ The Income Tax Act, 1961 is the legislation dealing with the areas covered under direct taxes.

9) ANTITRUST LAWS:

The Competition Act, which came into force in 2002, is an economic legislation for bringing about the economic development in our country. The primary aim of this piece of legislation is to avert practices having anti-competitive effects, for the advancement of competition in the markets, to safeguard the interests of the consumers and to guarantee freedom of trade to the market participants. This legislation is the successor to Monopolies and Restrictive Trade Practices Act, 1961. The Act lays down provisions relating to horizontal and vertical anti-competitive agreements having an adverse effect on competition, abuse of dominance, combinations and their regulation.

The Competition Commission of India (CCI) has also embarked on investigating the conduct of anti-competitive activities by Big-tech enterprises thriving on data. For instance, a recent probe conducted by the CCI has found social-media giant Google guilty of stifling innovation and thwarting competition to exert its dominance in the markets related to search, app library, music among others. The CCI probe also holds that Google has been espousing anti-competitive, unfair and restrictive trade practices by imposing one-sided contracts on devices and app-makers such that its products and apps come pre-installed on the devices garnering highest consumer preferences. The Commission will determine if this amounts to abuse of dominance under the Competition Act.

10) **FINANCE LAWS:**

Finance Laws are entrusted with the regulation of finance after taking into account the various risks that may be encountered amongst the financial players, such as banks, NBFCs, insurance companies etc. The main function of the finance laws is risk minimization, with the various risks being liquidity, management, credit, exchange rate, legal among others. This branch of law also deals with different kinds of consensual security such as mortgage, contractual lien, charge, pledge and perfection of security interest. Law of Finance also encompasses floating and fixed charges along with governing the process of consortium (or syndicate) finance and project finance.

The Reserve Bank of India (RBI) plays an extremely important role in the management and regulation of banks. For instance, last year, the Central Bank gave a go-ahead for the merger of debilitated Lakshmi Vilas Bank with Singapore DBS Bank's Indian subsidiary. This step was taken after many credible revival plans for the bank and safeguarding depositors failed to materialise.

11) **SECURITIES LAW AND REGULATIONS:**

Securities laws and Regulations, also known as Capital Market Laws and Regulations comprise the bunch of laws and rules that oversee the issuance of securities. Securities laws and regulations advise the corporations on the steps that need to be undertaken for offering their investments to the general public. They are extremely vital to the development of the market economy. The Laws associated with Securities may provide regulatory or transactional assistance, which assumes significant role in the conduct of business. In India, the Securities Contracts (Regulation) Act, 1956, governs the issuance of securities. The Securities and Exchange Board of India Act (SEBI) is entrusted the function of regulating the securities market and safeguarding the interests of the investors in securities.

12) **INTERNATIONAL BUSINESS LAW:**

International business involves the sale and purchase of goods across the border. It is the principal determinant for the aspects related to international trade and globalization. The major benefits of international business law transactions include increase in the level of profits, availability of advanced technology and raw materials, to explore avenues beyond domestic markets and for facilitating growth in market share.

13) FOREIGN EXCHANGE LAWS:

In India, the foreign exchange regulations are governed by the Foreign Exchange Management Act, 1999 (FEMA). The Reserve Bank of India is entrusted with the responsibility and management of the foreign exchange.

14) CONSUMER PROTECTION ACT, 2019:

The Consumer Protection Act, 2019, which replaced the Act of 1986, is intended to protect the interests of the consumers and laying down rules for the settlement of consumers' disputes. This Act also enlists various consumer rights, such as, the right to be protected against the marketing of goods, the right to be informed, the right to be heard, right to consumer awareness, and the right to seek redressal in case of exploitation, to name a few. The recent Act also incorporates provisions related to product liability actions and provides procedure for mediation.

15) LAW OF ARBITRATION:

Law of Arbitration plays an important role in resolution and settlement of disputes. The Arbitration and Conciliation Act of 1996, was enacted in order to define the laws in relation to conciliation, and for consolidating and amending the law relating to domestic arbitration, international commercial arbitration along with overseeing the enforcement of arbitral awards.

Arbitration is being considered as an effective means for dispute resolution in addition to the usual court conducted litigation. One of the recent instances of International Arbitration has been the case of US retail giant Amazon against the acquisition of Future Retail by Reliance Industries. The Singapore International Arbitration Centre (SIAC) had begun hearing the case last year, and in the course of proceedings, passed an emergency award supporting the claims of Amazon. The sale between Reliance and the Future Group's assets was thereby stayed. It was the contention of the Reliance Industries and Future Group that the Singapore Arbitration Centre's order was not binding in the South Asian Market. However, the Indian Supreme Court upheld the verdict of Singapore's Emergency Arbitrator (EA) award and was enforceable under Section 17(2) of India's Arbitration Act.¹⁷

16) INTELLECTUAL PROPERTY LAW:

Intellectual property is associated with the creations of the mind which are intangible in nature, and includes literary and artistic works, inventions and symbols. Intellectual property rights provide protection to patents, copyright, trademarks, industrial designs, geographical indications, trade secrets and semiconductor integrated circuits layout designs. Intellectual property and technological knowhow are proving immensely significant in the current industrial set-up. IP law can also help provide protection to innovative products, aid in differentiating one business from its rivals, and grant protection from the mutilation or destruction of artistic words. Intellectual property has gained immense significance in the current business environment due to the value it garners for an industry. The role played by intellectual property in contributing to the Research & Development (R&D) of a company is immense, especially at the time of merger or takeover of the company.

It undoubtedly holds true that intellectual property protection has been designed to promote innovation and stimulate creativity and to reward the

innovators for the risks undertaken by them.¹⁸ Intellectual property is a must for investors and scientists to expend time and monetary resources into R&D and in the absence of any incentives, such as the expectation of financial gains in return, no one may be willing to innovate. Intellectual property, in the form of patents and technological knowhow have also taken up an extremely significant role in the current vaccine unavailability crisis, with big pharmaceutical companies unwilling to share the trade secrets with other countries fearing loss of profits.

The following are the legislations governing the law of intellectual property in India:

- The Patents Act, 1970: This Act governs the protection of patentable inventions in India. The Patent protection is offered for a period of 20 years under this Act.
- The Copyright Act, 1957: This Act provides for the consolidation of laws related to Copyright protection by granting protection to literary, dramatic, musical, artistic works, cinematographic works and sound recordings. Under this Act, copyright protection is granted for a period of sixty years plus the life of the author.
- The Trademarks Act, 1999: This Act was enacted to consolidate the law relating to trademarks, providing for registration and protection of trademarks for goods and services and for further preventing use of fraudulent marks. The protection for trademarks lasts for twenty-five years under this legislation.
- The Designs Act, 2000: This Act was enacted to amend the law relating to protection of designs. The protection offered for the designs registered under this Act is for ten years.
- The Semiconductor Integrated Circuits Layout-Design Act, 2000: This Act was enacted to secure protection of semiconductor integrated circuits layout-designs. The duration of registration under this Act is for a period of ten years.

17) INSOLVENCY LAW:

The Insolvency and Bankruptcy Code, was enacted in the year 2016, for addressing issues related to reorganization and insolvency of individuals, partnership firms and corporate persons in minimal time with a view to increase the value of the assets. The code further strives to promote entrepreneurship, availability of credit and to satisfy the interests of all the shareholders.

Corporate insolvency resolution process, under Section 14 of this Act also includes the process of declaring moratorium, which prohibits the performance of acts allowing the institution of suits, continuing the proceedings or following up on pending suits against the corporate debtor. This provision also blocks any act that results in transfer, encumbrance, alienation or disposal of assets by the corporate debtor, and any act seeking foreclosure, recovery or enforcement of security interest made by the corporate debtor with regards to the property in question.

18) COMMERCIAL COURTS ACT, 2015

The Commercial Courts Act was brought forth in 2015, for the creation of Commercial Courts, Commercial Appellate Courts, Commercial Division and Commercial Appellate Division in the High Courts for resolving commercial disputes of specified value. A Commercial Court is empowered to handle complex commercial disputes in a time bound manner. The Act also is also embedded with specialized features such as, pre-institution settlement (offering a mode for a pre-trial conference for settlement), and case management hearing (court providing a timeline before the start of the trial for the entire life-cycle of the suit).

**2.5 BASIC SCHEME OF LITIGATION-
RESOLUTION THROUGH COURTS**

In India, the adjudication of disputes is carried out by the judiciary. The Court system follows a hierarchical structure with the Supreme Court at the apex, being the Union Judiciary. The Supreme Court is empowered to exercise original, appellate and extraordinary jurisdiction. The State Judiciary comprises of High Courts, entrusted with the power to supervise the functioning of all other lower courts and tribunals in the Country, including district courts. The adjudicatory courts are categorized into Civil Courts and Criminal Courts.

India follows an adversarial form of system. A plaintiff is the party bringing a lawsuit before a court of law in pursuance of a legal remedy. A defendant is the party against whom relief is sought in a Civil proceeding. The Code of Civil Procedure, 1908, governs the procedure in relation to civil suits. The code lays down the substantive and procedural aspects in the form of provisions and orders drafted in the code for regulating the proceedings in courts of civil judicature. The orders provide for rules in regards to parties to the suits, framing and institution of suits, the particulars to be present in pleadings, complaints and written statements, pronouncement of judgement or decree, among others. The Code also provides rules regarding the grant of temporary and permanent injunction, and summary procedure.

2.6 ALTERNATIVE DISPUTE RESOLUTION

The path of litigation and use of the court system to resolve the commercial disputes usually takes years to resolve and costs a lot due to the legal fees and expenses. During the process of litigation, the normal business operations are hampered and disrupted. In order to avoid these issues, the businesses usually prefer the mode of settlement without involving the courts. Here the disputes are resolved outside the court judicial system this is often referred to as the Alternative Dispute Resolution (ADR). ADR is being increasingly used to resolve legal problems as it provides many benefits in terms of quick redressal and resolution and are much cheaper than litigation. ADR includes within its scope arbitration, negotiation and mediation.

The active participation by the parties in the negotiations produces satisfying results for both the parties. The flexibility offered by the ADR methods can prove useful in combating the ever-increasing backlog of cases. These also address the delays associated with the onerous procedure of litigation. The sheer volume of

cases, lengthy and time-consuming procedures for appeals and review further aggravate the delays in the finality of proceedings in an adversarial set-up, overwhelming the system. This may also thwart investments as firms looking to invest in the country may be cautious on evaluation of legal and financial risks, that the exit mechanism may be drawn-out pending the resolution of laborious litigation. ADR techniques are gaining popularity due to the flexibility in procedures and the wide range of innovative solutions available at disposal based on the problem at hand, side-stepping the rigidity associated with precedents giving rise to creative ideas.

“The technique of ADR is an effort to design a workable and fair alternative to our traditional judicial system. It is a fast-track system of dispensing justice. These techniques have been developed on scientific lines in USA, UK, France, Canada, China, Japan, South Africa, Australia and Singapore. ADR has emerged as a significant movement in these countries and has not only helped reduce cost and time taken for resolution of disputes, but also in providing a congenial atmosphere and a less formal and less complicated forum for various types of disputes. The advantage of ADR is that it is more flexible and avoids seeking recourse to the courts. In conciliation/mediation, parties are free to withdraw at any stage of time. It has been seen that resolution of disputes is quicker and cheaper through ADR. The parties involved in ADR do not develop strained relations; rather they maintain the continued relationship between themselves.”¹⁹

NEGOTIATION	Past events are dealt with in order to reach future agreements. Non-adversarial method: both sides win. They make compromises and look for and agreement that satisfies common interests. A third party does not intervene. The process is voluntary. The parties are the ones that resolve the situation.
MEDIATION	Try to reach an agreement to improve future relationships. Non-adversarial method: both sides win. They look for mutual understanding and collaborate to reach an agreement that both sides find satisfactory. A third party intervenes; the mediator/s that control the process and help the parties identify and satisfy their interests. This is done among equals. The process is voluntary. The mediator proposes solutions and the parties resolve the situation.
CONCILIATION	This is where past issues are resolved without a commitment for the future. Non-adversarial method; both sides win. Reconciliation is sought after. A third party intervenes and brings both parties together to talk or transmit information between each other. The process is voluntary. The parties resolve the conflict.
ARBITRATION	Post events are discussed and the arbitrator makes a recommendation that the parties can accept or reject. Adversarial method: one side wins and the other side loses. A third party intervenes. This tends to be the person with more authority. The process is voluntary. The two sides present their needs, interests and positions to the arbitrator. The sides are not autonomous when it comes to the result, as the result is imposed by the third party.
TRIAL	The parties lose their power to resolve the conflict. Adversarial method. A neutral third party intervenes the judge dictates the sentence that ends the process and resolves the conflict. The sentence is a mandate so it holds weight, ties and obliges. This is not a voluntary process.

Figure 2.3²⁰

Section 89 of the Civil Procedure Code (CPC), 1908, enlists the different ADR techniques that the Court may refer to after reformulating the terms of possible settlement between the parties, if it appears to the Court that the parties to the dispute may be willing to settle. The court may formulate the terms of settlement of a dispute and after receiving observations of parties refer the terms to arbitration, conciliation, judicial settlement through Lok Adalat or mediation.

2.7 SUMMARY

The diverse set of legislations enacted by the law-making bodies promote effective regulation and promotion of business activities, and aid in designing a framework which encourages smaller enterprises to expand their business offering a level-playing field. Thus, Business laws play a significant role in shaping the economy of the country.

2.8 SELF ASSESSMENT QUESTIONS

- 1) What are the main concepts under Business Law?
- 2) What is the significance of business ethics in the development of business laws?
- 3) What is the provision under the Civil Procedure Code, 1908 which refers to settlement of disputes outside the Court?
- 4) Which Act was previously responsible for governing issues related to the sale of goods?
- 5) Which chapter under the Companies Act, 2013 deals with incorporation of any company?
- 6) In which year did the Goods and Services Tax (GST) Act come into force?
- 7) Which Article under the Indian Constitution governs provisions in relation to tax?
- 8) Which legislation was the predecessor to the Competition Act, 2002?
- 9) What does *Consensus ad idem* under the Indian Contract Act, 1872 mean?
- 10) Which case challenged the Constitutional validity of the Insolvency and Bankruptcy Act, 2016?
- 11) Name the new provisions of the Consumer Protection Act, 2019?

2.9 FURTHER READINGS/ REFERENCES

Weblinks:

- 1) <https://legislative.gov.in/sites/default/files/A1872-09.pdf>
- 2) https://legislative.gov.in/sites/default/files/A1930-3_0.pdf
- 3) <https://legislative.gov.in/sites/default/files/A1881-26.pdf>
- 4) https://www.mca.gov.in/Ministry/actsbills/pdf/Partnership_Act_1932.pdf
- 5) <https://www.mca.gov.in/Ministry/pdf/CompaniesAct2013.pdf>
- 6) <https://www.incometaxindia.gov.in/pages/acts/income-tax-act.aspx>
- 7) https://www.cci.gov.in/sites/default/files/cci_pdf/competitionact2012.pdf

- 8) <https://www.indiacode.nic.in/handle/123456789/15256?locale=en>
- 9) <https://www.indiacode.nic.in/bitstream/123456789/1978/1/AAA1996-26.pdf>
- 10) <https://www.mca.gov.in/Ministry/pdf/TheInsolvencyandBankruptcyofIndia.pdf>
- 11) <https://legislative.gov.in/sites/default/files/A1908-05.pdf>
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- ³ Henry Cheeseman, BUSINESS LAW, 6 (Pearson 2016)
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- ⁵ Kubasek Nancy et. al., DYNAMIC BUSINESS LAW: THE ESSENTIALS 14 (McGraw Hill Education 2016)
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- ⁷ Supra note 1, at 8
- ⁸ Supra note 6, at 9
- ⁹ Supra note 6, at 10
- ¹⁰ Supra note 8, at 7
- ¹¹ Supra not 6, at 6
- ¹² Supra note 5, at 13
- ¹³ Supra note 6, at 187
- ¹⁴ Supra note 6, at 187
- ¹⁵ Community week event, <https://laout.org/community-equity-event/> (Last visited on May 20, 2021).
- ¹⁶ *The tax structure in India is divided into direct and indirect taxes.*<https://www.investindia.gov.in/taxation> (Last visited Sept. 16, 2021).
- ¹⁷ H.R Ranina, *Amazon-Future Group verdict: Indian cos should opt for arbitration in India*, (Aug, 06, 2021)<https://economictimes.indiatimes.com/markets/expert-view/amazon-future-group-verdict-indian-cos-should-opt-for-arbitration-in-india-says-hr-ranina/articleshow/85096749.cms>
- ¹⁸ James Bacchus, *An Unnecessary Proposal: A WTO Waiver of Intellectual Property Rights for COVID-19 Vaccines*, CATO INSTITUTE, (Jun. 01 2021), <https://www.cato.org/publications/free-trade-bulletin/unnecessary-proposal-wto-waiver-intellectual-property-rights-covid>.
- ¹⁹ <http://www.legalservicesindia.com/article/224/ADR-Mechanism-in-India.html> (Last visited on 20/05/2021); Refer also to https://lawcommissionofindia.nic.in/adr_conf/concepts%20med%20rao%201.pdf
- ²⁰ <https://www.ddfsocialelearning.com/alternative-methods-to-resolving-conflict/tabla-mediacion-ingles/> (Last visited on May 20, 2021)

BLOCK-2

BUSINESS FORMS AND LEGISLATIONS

Unit 3 : The Partnership Act, 1932

Unit 4 : The Companies Act, 2013



UNIT 3 THE PARTNERSHIP ACT, 1932

Objectives

On completion of studying this Unit, you will be able to:

- Define partnership and explain its essential features
- Describe different types of partners and partnerships
- Differentiate between partnership and other forms of organization.
- Discuss how registration of a partnership firm can be done
- Explain the circumstances when a partnership is reconstituted and a firm is dissolved
- Appreciate the meaning of the term 'Limited Liability Partnership'(LLP), its need, scope advantages and incorporation of LLP

Structure

3.1 Introduction

3.2 Nature of Partnership

- 3.2.1 Definition of Partnership, 'Partners', 'Firm' and 'Firm's name'
- 3.2.2 Essentials of a Partnership
- 3.2.3 Types of Partner
- 3.2.4 Position of Minor as a Partner
- 3.2.5 Types of Partnerships
- 3.2.6 Partnership distinguished from other Forms of Organisation

3.3 Formation and Registration of Partnership

- 3.3.1 Formation of Partnership
- 3.3.2 Partnership Deed
- 3.3.3 Registration of Partnership
- 3.3.4 Effects of Non-Registration

3.4 Relation of partners to one Another

- 3.4.1 Rights of Partners
- 3.4.2 Duties of Partners

3.5 Relation of Partners to Third Parties

- 3.5.1 Partners as Agents
- 3.5.2 Authority of a Partner

3.6 Reconstitution of Firm

- 3.6.1 Admission of Partner
- 3.6.2 Retirement of Partner
- 3.6.3 Expulsion of partner
- 3.6.4 Death or Insolvency

3.7 Dissolution

3.8 Limited Liability Partnership Act, 2008

3.9 Differences with other Forms of Organisation

3.10 Advantages and Disadvantage of LLP

- 3.11 Incorporation of LLP
- 3.12 Summary
- 3.13 Self Assessment Questions
- 3.14 Further Readings

3.1 INTRODUCTION

The development of business and growth in business transactions lead to the replacement of the proprietary form of organizations with partnership enterprises. Partnership is a form of business organization, where two or more persons come together for jointly carrying on some business. In partnership two or more persons pool their resources; both money and material, to their mutual advantage and thus share the business risk.

Towards the end of 19th century it was considered absolutely crucial to regulate the partnership form of business, so as to control the evils (many evils crept in over passage of time) from spreading and contaminating the business organization and mercantile transactions.

Initially, The Indian Contract Act, 1872, governed all aspects of Commerce and trade and Chapter IX, sections 239 to 266 of the Act regulated the partnership business. But these provisions were not exhaustive. Many aspects remained unnoticed and unregulated. This led to a need for more specific governance and the government took steps to legislate further. Chapter IX, sections 239 to 266 are replaced by Indian Partnership Act, 1932. It is based on the English Partnership Act, 1890.

Partnership is a mere voluntary collective and has no force of law to its constitution. Thus, the concept of partnership is that a firm is not an entity or a person in law but is merely an association of persons and the firm name is only a collective name for individuals who have agreed to carry on business in partnership. A Partnership arises from a contract, and therefore, such a contract is governed not only by the provisions of the Partnership Act in that regard, but also by the general law of contract in such matters, where the Partnership Act does not specifically make any provision. Thus, the rules relating to offer and acceptance, consideration, free consent, legality of object, etc, as contained in the Indian Contract Act, are applicable to a contract of Partnership also.

3.2 NATURE OF PARTNERSHIP

3.2.1 Definition of Partnership, ‘Partners’, ‘Firm’ and ‘Firm’s Name’

Section 4, The Indian Partnership Act, 1932, lays down the definition of “Partnership”, “Partner”, “Firm” and “Firm-Name”.

“Partnership” is the relationship between persons who have agreed to share the profits of the business carried on by all or any of them acting for all”.

There are three aspects to partnership: partners, firm, and the firm name.

Persons who have entered into partnership with one another are called individually **‘partners’** and collectively **‘a firm’**, and the name under which the business is carried on is called the **‘firm’s name’**.

Thus “a firm” in law is only a collective name of the partners of a partnership. It doesn’t have a separate legal existence as is in a corporation.

While acquiring the “firm name”, the partners should keep in mind that they do not violate the rules relating to trade name or goodwill. The adopted name must not mislead the public to confuse them with a firm of repute already in existence with a similar name. They must not use a name implying the sanction of patronage of the Government. A partnership firm cannot use the word “Limited” as a part of its name.

3.2.2 Essentials of a Partnership

The examination of the definition of partnership given in section 4 of the Act indicates that the following elements must co-exist before a partnership can come into existence:

- 1) There must be **minimum two persons**.
- 2) The relationship must arise out of an **agreement** between two or more persons to carry on a **business**
- 3) The agreement must be to **share the profits** of a business
- 4) The business must be carried on **by all or any of them acting for all**.
- 5) Each **partner is liable** for all the acts of a firm done by a partner.

We shall now discuss the aforesaid elements, briefly:

- 1) **Association of two or more Persons:** In order to form partnership, there must be a contract between two or more persons coming together for a common goal. Persons must be competent to enter into a contract. They may all be natural or artificial or some natural and other artificial -

There are at least two persons required otherwise it cannot be a partnership. If this number gets reduced to one for reason like death or insolvency, the partnership ceases to exist. The Act is silent on the maximum number of partners but section 464 of the Companies Act, 2013 has now put a limit of 50 partners in any association/partnership firm. The Companies Act, 2013, lays limit on number of partners in a partnership as under:

- a) The Central Government has prescribed maximum number of partners in a firm to be 50 vide Rule 10 of the Companies (Miscellaneous) Rules, 2014.
- b) Section 464 (1) of the Companies Act 2013 states “provided that the number of persons which may be prescribed under this sub-section shall not exceed one hundred.

Thus, the ceiling under rules can be varied but under no circumstance can go beyond 100.

- 2) **Agreement:** According to section 5, the relation of partnership arises from contract and not from status; thus, the members of a Hindu undivided family carrying on a family business, or a Burmese Buddhist husband and wife carrying on business, are not partners in such business. The agreement is the basis of relationship between the partners. The agreement can be in written

or oral form. But it is preferred that the partners have a written agreement so that in case of dispute there is a greater clarity as to their relation and position.

- 3) **Business:** The agreement should be to carry on some lawful business. The term “business” includes trade, occupation and profession (Section 2(b) of the Act). In the definition of partnership the word “business” means “carrying on business” that is continuity or repetition of acts. But that doesn’t mean it should be lengthy operations, even a single venture of an undertaking, if there is continued participation of two or more persons for acquisition of gains is considered.
- 4) **Sharing of Profit:** To constitute a partnership, the parties must have agreed to carry on a business (not a charitable activity) and to share profits in common. Unless otherwise agreed sharing of profits also involves sharing of losses as well. However, the sharing of profit is an essential element of partnership, the sharing of losses is not. The partners can agree to share the profits in any ratio and either in specific proportions or in specific sums, but if only one partner is entitled to whole of the profit then there will be no partnership.
- 5) **Mutual Agency:** The business of a partnership concern may be carried on by all the partners or any of them acting for all. This statement has two important implications. First, every partner is entitled to participate in the conduct of the affairs of its business. Second, that there exists a relationship of mutual agency between all the partners. Each partner carrying on the business is the principal as well as the agent for all the other partners. He can bind other partners by his acts and also is bound by the acts of other partners with regard to business of the firm.
- 6) **Liability of Partners:** Each partner is liable jointly and severally to the third party for all the acts of the firm done while he is a partner. The liability of a partner for acts of the firm is unlimited i.e., the partners private assets can also be used for paying off the firm’s debts.

3.2.3 Types of Partner

There are basically two categories of partners:-

- i) Partners by virtue of Partnership Agreement; and
- ii) Partners by virtue of holding out [section 28]

The Act does not provide about the types of partners. This is decided on the partnership contract. In practice based on the extent of liability, the different classes of partners are:

- 1) **Actual, Active or Ostensible Partner:** Such a partner actively participates in the functioning and management of the business and shares its profits or losses. He acts as an agent of other partners for all acts done in the ordinary course of business. In the event of his retirement, he must give a public notice in order to absolve himself of liabilities for acts of other partners done after his retirement.
- 2) **Sleeping or dormant partners:** These partners invest money in the firm’s business and share profits but do not participate in the functioning and management of the business. However, they are liable to the third parties

for all acts of the firm. Such a partner can retire from the firm without giving any public notice to this effect. His liability for the acts of the firm ceases soon after retirement. Such partner has no duties to perform but is entitled to have access to books and accounts of the firm and he can have a copy of them.

- 3) **Nominal partner:** Such a partner neither invests nor participates in the management of the firm but only gives his name to the business or firm. However, such partners are liable to third parties for all the acts of the firm. Unlike a sleeping partner, they are known to the outsiders as partners in the firm, whereas they are not. They require to give public notice at the time of being separated from the firm.
- 4) **Partners in profit only:** A partner, who is entitled to share in the profits of a partnership firm without being liable to share the losses, is called a partner in profits only. Thus, a person who has sufficient capital but is not prepared to take risk may be admitted to the partnership by the other partners. In spite of his specific position, he continues to be liable to the third parties for all acts of the firm, just like other partners.
- 5) **Sub-partner:** Where a partner agrees to share his profits in the firm with a third person, that third person is called a sub-partner. A sub-partner is not the partner in firm. He is partner of a partner. A sub-partner has no rights or duties towards the firm and does not carry any liability for the debts of the firm. He can neither participate in partnership business nor check the accounts of such partner and claim share. Also he cannot bind the firm or other partners by his acts. The only right he has to share the profits in property at the time of winding-up.
- 6) **Partner by 'estoppel' or by holding out:** If a person by his act or words, gives another person reason to believe that he is a partner in a firm (when actually he is not) and that other person takes action on those set of facts, such a person is estopped from later on denying the liabilities for the acts of the firm. Thus, it is a legally binding partnership that may occur where previously, no formal partnership agreement was in place. Such person is called partner by estoppel and is liable to all third parties. Similarly, when the firm declares a person to be a partner (when actually he is not), and that person knowingly permits himself to be represented, to be a partner in a firm or does not deny the fact that he is a partner, then such a person is known as **partner by holding out**. An active partner who fails to give public notice at the time of retirement is also liable as **partner by holding out**.

3.2.4 Position of Minor as a Partner

Minor Admitted to the Benefits of Partnership:

Since partnership is a contractual relationship. The parties to contract must be competent to contract under the law to which they are subject. A minor is incompetent to contract. Hence, he cannot become a partner but, with the consent of all the partners, he may be admitted to the benefits of partnership.

Rights of Minor:

He is entitled to share of the property and of the profits of the firm as agreed upon. He can have access to and inspect and copy any of the accounts of the firm but not any other book [section 30(2)]

A minor can sue the partners for an account or payment of his share of the property or profits of the firm, when severing his connection with the firm. The amount of his share shall be determined by a valuation made as far as possible in accordance with the rules contained in section 48.

Liabilities of Minor:

A minor is liable to the extent of his share in the firm. He is neither personally liable nor is his private estate liable for the acts of the firm. He cannot be declared insolvent if the firm's debts cannot be paid out of the firm's property.

Position on attaining majority:

A minor has a choice to become a partner, or sever his connection from the firm, within six months of his attaining the age of majority or when he comes to know of his being admitted to the benefit of partnership, whichever date is later.

He has to give a public notice if he intends to become or that he has elected not to become a partner in the firm within six months. If he fails to give such notice, he shall become a partner in the firm on the expiry of the said six months. [Section 30(5)]

Where such person becomes a partner-

- a) his right and liabilities as a minor continue up to the date on which he becomes a partner,
- b) he also becomes personally liable to third parties for all acts of the firm done since he was admitted to the benefits of partnership, and
- c) his share in the property and profits of firm shall be the share to which he was entitled as a minor.

Where such person elects not to become a partner-

- a) his rights and liabilities shall continue to be those of a minor under this section up to the date on which he gives public notice,
- b) his share shall not be liable for any acts of the firm done after the date of the notice, and
- c) he shall be entitled to sue the partners for his share of the property and profits

3.2.5 Types of Partnerships

A partnership may be for - a particular adventure or for a fixed period or at will. From the duration point of view, a partnership may be classified into the following two:

- i) Partnership-At-Will (Section 7)
- ii) Particular Partnership (Section 8)
- i) ***Partnership-At-Will:*** According to Section 7 of the Act, partnership is at will when:
 - i) no fixed period has been agreed upon for the duration of partnership, and
 - ii) there is no provision made as to the determination of partnership in any other way.

The death or retirement of a partner does not affect the existence of such partnership as there is no fixed or definite date of termination. Such a partnership can be dissolved by any partner giving notice in writing to all the other partners of his intention to dissolve the firm [Section 43(1)]. The firm is dissolved from the date mentioned in the notice as the date of dissolution or, if no such date is mentioned, as from the date of communication of the notice”.

- ii) Particular Partnership:** When a partnership is formed for a particular adventure or undertaking or for a particular period, such a partnership is called “Particular Partnership. Such partnership automatically comes to an end on completion of venture or on expiry of the period. If partners want to dissolve the partnership before fixed period it can be done by mutual consent and if the partnership is continued after the expiry of the term or completion of venture it is deemed to be partnership at will.

3.2.6 Partnership Distinguished from other Forms of Organisation

i) Co-ownership and Partnership:

If two or more persons own a property jointly and employ the same property in a business and share the profits, it is co-ownership and not partnership. The main point of distinction between the two is:

- 1) Partnership always arises out of a contract, express or implied. Whereas co-ownership may arise from an agreement or by the operation of law or from status or any other way. e.g., co-heirs of a property.
- 2) A partner is the agent of the other partners, but a co-owner is not the agent of the other co-owner(s).
- 3) Partnership involves sharing of profits and loss. Whereas co-ownership does not necessarily do so.
- 4) A partner cannot transfer his rights and interests to anyone without the consent of all other partners. However, a co-owner can do so without the consent of the others.
- 5) A partner can only ask for share of the profits out of the properties. Whereas a co-owner can ask for division of property,
- 6) A partner has a lien on the firm property whereas co-owner doesnot.

ii) Hindu Joint Family Firm and Partnership:

A Hindu joint family firm differs from a partnership in the following ways:

- 1) A partnership arises out of contract and a Hindu joint family (HUF) firm out of status, i.e., by birth in the family.
- 2) Partnership is governed by Indian Partnership Act and HUF by Hindu Law
- 3) A minor cannot be a partner, although he may be admitted to the benefits of partnership. Whereas, in HUF a minor is a member from the very day of his birth by virtue of his status, but he is not personally liable.

- 4) The death of a partner dissolves the partnership, but the death of a co-parcener does not.
- 5) In partnership each partner has implied authority to borrow and bind other partner but in HUF firm only the Karta or manager (who is the head of the family) is entitled to do so.
- 6) Every partner is personally liable for the debts of the firm; but in a HUF business only the Karta is personally liable.
- 7) A partner can demand the accounts of the firm, a co-parcener cannot ask for accounts; his only remedy is to ask for partition of the assets of the family firm.
- 8) Partnership firm must be registered before it can maintain suits against outsiders. Whereas for HUF no registration is necessary.
- 9) Every partner has a definite share and it can be changed only by agreement, but the share of a coparcener enlarges or reduces depending on death or birth in family.
- 10) There is a definite limit to the number of partners, but there is no such limit in the case of a Hindu joint family firm.

Activity 1

- 1) Can the following be called partnership?
 - a) Several persons jointly purchase goods for resale with a view to divide the profits arising from the transaction.
 - b) Widow or child of a deceased receiving profits
 - c) Persons who join in the purchase of goods for the purpose of dividing the goods themselves.
 - d) A. B and C agreed that each should furnish Rs. 3000 worth of goods to be shipped on a joint venture, the profits is to be divided between them according to the amount of their several shipments
 - e) Two tenants in common of a house and divide the rent equally
- 2) Tick the right answer:
 - a) Where a partnership firm is constituted for a fixed period and after expiry of that term the firm continues its business without any agreement
 - i) The partnership becomes the partnership at will
 - ii) The partnership becomes illegal
 - b) Which is not an essential element of partnership firms?
 - i) Perpetual succession ii) Mutual agency
 - c) The relationship of partnership arises from
 - i) Contract ii) status
 - d) which of the following is the conclusive test of partnership
 - i) sharing of profit ii) mutual agency relationship
 - e) Goodwill of the business is the property of the business in absence of contract to contrary. True/False.

3.3 FORMATION AND REGISTRATION OF PARTNERSHIP

3.3.1 Formation of Partnership

Partnership comes into existence by contract and this contract may be written or oral- or implied, which is inferred from the conduct of the parties in business circumstances. According to the definition of partnership under the Indian Partnership Act, 1932, there must be an agreement between the partners of a partnership firm.

To constitute a valid contract, the parties to the contract must be competent to contract, their consent must be free and objective should not be forbidden by law or immoral or opposed to public policy. However, two exceptions may be noted:

- i) A minor may be admitted to the benefits of an existing partnership firm with the consent of all other partners.
- ii) As relations of partners inter se are that of agency, no consideration is required to create the partnership.

3.3.2 Partnership Deed

As already stated the agreement of partnership may be oral. But it is advisable to have it in writing so as to avoid any future disputes. The written document that contains the mutual rights and obligations of partners is known as partnership deed. The deed must be stamped according to the provisions of the Indian Stamp Act and copy of the same must be given to each partner and at the time of registration, a copy of the deed should be filed with the Registrar of Firms. The partnership deed is not a public document and therefore binds only third parties so far as they have notice of it.

Contents of Partnership Deed

The exact terms of the partnership deed (or agreement) will depend upon the circumstances but generally a partnership deed contains the following covenants:

- i) The firm name, date of establishment, duration of partnership .
- ii) Full names and permanent addresses of all the partners and the date when each partner joined the firm.
- iii) Nature and scope of business; the place or principal place of business of the firm,.
- iv) Total capital and the contribution by each partner.
- v) Provision for further capital and loans by partners to the firm.
- vi) Partner's drawings,
- vii) Interest on capital, loans, drawings and current account.
- viii) Salaries, commission and remuneration to partners,
- ix) Profit sharing ratio of partners.
- x) Guideline for maintaining proper books of accounts, inspection and audit, Bank Accounts and their operation.

- xi) Rights and duties of the partners.
- xii) Whether and in what circumstances, notice of retirement or dissolution can be given by a partner.
- xiii) Provision that death or retirement of a partner will not bring about dissolution of partnership,
- xiv) Valuation of goodwill on retirement, death, dissolution, etc.
- xv) The method of valuation of assets (and liabilities) on retirement or death of any partner.
- xvi) Provision for expulsion of a partner.
- xvii) Provision regarding the allocation of business activities to be performed by individual partners
- xviii) The arbitration clause for the settlement of disputes. The terms contained in the partnership deed may be varied with the consent of all the parties, and such consent may be express or implied by a course of dealing. [Section 11(1)]

3.3.3 Registration of Partnership

Registration of Partnership is not mandatory in India. But registering with a document deed puts into black and white all the intentions and the purposes of the partnership as well as its functioning. However, it is to be noted that registration only creates an instance or evidence of the existence of partnership, and not a creation of a legal entity.

Registration means getting the firm registered with the Registrar of the firm in the area where the business is situated or proposed to be situated.

Application for Registration

The registration of a firm may be affected at any time by sending by post or delivering to the Registrar of the area in which any place of business of the firm is situated or proposed to be situated, a statement in the prescribed form and accompanied by the prescribed fee, stating:

- a) the name of the firm;
- b) the place or principal place of business of the firm;
- c) the names of any other places where the firm carries on business;
- d) the date when each partner joined the firm;
- e) the names in full and permanent addresses of the partners; and
- f) the duration of the firm

The statement shall be signed and verified by all the partners or by their agents specially authorised in this behalf. (Section 58)

Registrar on being duly satisfied, record an entry of the statement in “Register of Firm” and then issue a certificate of registration. The firm, which is registered, shall use the brackets and word (Registered) immediately after its name. If, any change is made in points (a) to (f) above same should be duly notified to the registrar so that the same is incorporated in the register of the firm.

3.3.4 Effects of Non-Registration

Non-registration (**section 69**) leads to following effects:

- i) The partners of a firm cannot sue each other or the firm for enforcing any right arising from a contract or conferred by the Partnership Act,
- ii) The firm cannot institute a suit against a third party. Thus the firm cannot sue but can be sued.
- iii) The third party can sue the firm as well as any partner

However, the Act allows the following suits:

- a) A suit for the dissolution of a firm.
- b) A suit for rendering of accounts of a dissolved firm.
- c) A suit for realisation of the property of a dissolved firm.
- d) A suit or claim of set-off, the value of which does not exceed one hundred rupees,
- e) A proceeding in execution or other proceeding incidental to or arising from a suit or claim for not exceeding one hundred rupees in value.
- f) A suit by a firm which has no place of business in the territories to which the Indian Partnership Act extends.
- g) A suit for the realisation of the property of an insolvent partner.
- h) A suit by a firm whose places of business are situated in areas which are exempted from the application of Chapter VII of the Indian Partnership Act, 1932

Exceptions: Non-registration of a firm does not, however affect the following rights:

- a) The right of third parties to sue the firm or any partner.
- b) The right of partners to sue for the dissolution of the firm or for the settlement of the accounts of a dissolved firm, or for realization of the property of a dissolved firm.
- c) The power of an Official Assignees, Receiver of Court to release the property of the insolvent partner and to bring an action.
- d) The right to sue or claim a set-off if the value of suit does not exceed Rs. 100 in value.
- e) The right to suit and proceeding instituted by legal representatives or heirs of the deceased partner of a firm for accounts of the firm or to realise the property of the firm.

Activity 2

1) Whether following is true or false?

- a) The relationship of partnership is created by contract which can be expressed or implied.
- b) As relations of partners inter se are that of agency, no consideration is required to create the partnership.

- c) Partnership deed can be prepared on plain paper as it is not mandatory to have one.
 - d) Registration only creates an instance or evidence of the existence of partnership, and not a creation of a legal entity.
 - e) If a partnership firm is not registered it cannot institute a suit against a third party.
- 2) Fill in the blanks:
- a) Registration of partnership is _____
 - b) A non registered firm can file suit for _____ of firm.
 - c) Non registration does not affect the right of _____ party to sue any partner or firm.
 - d) Non-registration of a firm does not, however affect the right to sue or claim a set-off if the value of suit does not exceed '____' in value.
 - e) The firm, which is registered, shall use the brackets and word _____.

3.4 RELATION OF PARTNERS TO ONE ANOTHER

The deed of registration drawn and agreed by the partners governs the requisite relationship among the partners. In the event where there is no specific mention of mandatory relationship, sec 9-17 are applicable. These cover the general duties of a partner, the duty to indemnify for loss caused by fraud, the conduct of business, mutual rights and liabilities, property of firm, profits, etc.

3.4.1 Rights of Partners

Unless otherwise agreed by the partners, the following rules apply:

A) Right of partners in normal course

- i) ***Right to participate in the conduct of the Business [Section 12(a)]:*** Every partner has a right to take part in the conduct and management of the business.
- ii) ***Right to be consulted [Section 12(c)]:*** Every partner has right to express his opinion, before the matter is decided, but no change may be made in the nature of the business without the consent of all the partners. However, the ordinary matters connected with the business may be decided by majority of the partners.
- iii) ***Right of access to books [Section 12(d)]:*** Every partner, has a right to access and inspect and copy all records, books and accounts of the business.
- iv) ***Right of legal heirs/ representatives/ their duly authorised agents [Section 12(e)]:*** The heirs or legal representatives or the duly authorised agents of deceased partner shall have a right of access to and to inspect and copy any of the books of the firm.
- v) ***Right to share Profits [Section 13(b)]:*** Unless there is contract to the contrary the partners are entitled to share equally in the profits, and shall contribute equally to the losses sustained by the firm. There is no connection between the proportion in which the partners shall share the profits and the proportion in which they have contributed towards the capital of the firm.

- vi) **Interest on Advances [Section 13(d)]:** Any contribution beyond the amount of capital agreed by partner to subscribe, is entitled to an interest at a rate agreed upon, and where no rate is stipulated for, at six per cent per annum. But it is to be noted that a partner cannot claim interest on capital, unless there is an agreement to pay it.
 - vii) **Interest on Capital [Section 13 (c)]:** A partner can be entitled to interest on capital if there is (i) an express agreement to that effect, or practice of the particular partnership or (ii) any trade custom to that effect; or (iii) a statutory provision which entitles him to such interest. This interest is payable only out of profit.
 - viii) **Right to be indemnified [Section 13(e)]:** A partner is entitled to be indemnified by the firm for all expenses incurred by him-
 - a) in ordinary and proper conduct of the business, and
 - b) for all payments made by him in respect of partnership debts or liabilities and disbursements made in an emergency for protecting the firm from loss, if the payments, liability and act are such as a prudent man would make, incur or perform in his own case, under similar circumstances.
 - ix) **Right to use partnership property (Section 15):** Every partner is, as a rule, a joint owner of the partnership property, and has it applied exclusively for the purposes of the partnership.
- B) Right of Partners in special circumstances**
- i) **Right in emergency (Section 21):** A partner has power to act in an emergency for protecting the firm from loss.
 - ii) **Right to prevent admission of new partner (Section 31):** A new partner can be admitted only with the consent of all the partners. Therefore, the dissenting partner has right to stop admission of a partner.
 - iii) **Right to Retire:** a partner may retire-
 - a) With the consent of all the partners,
 - b) In accordance with an expressed agreement by partners,
 - c) by giving notice where the partnership is at will. [Section 32(1)(c)].
 - iv) **Right to continue as partner:** Every partner has a right to continue in the partnership and not to be expelled from firm by any majority of the partner. [Section 33(1)]
 - v) **Right of an outgoing partner to carry on competing business (Section 36):** An outgoing partner may carry on a business competing with that of the firm and he may advertise such a business, but, subject to contract to the contrary, he may not-
 - a) Use the firm's name,
 - b) Represent himself as carrying on the business of the firm, or
 - c) Solicit the custom of persons who were dealing with the firm before he ceased to be a partner.

- vi) ***Right To Share Subsequent Profits (Section 37):*** Where any member of a firm has died or otherwise ceased to be a partner, and the surviving or continuing partners carry on the business of the firm with the property of the firm without any final settlement of accounts as between them and the outgoing partner or his estate, then, in the absence of a contract to the contrary, the outgoing partner or his estate is entitled at the option of himself or his representatives to such share of the profits made since he ceased to be a partner as may be attributable to the use of his share of the property of the firm or to interest at the rate of six per cent per annum on the amount of his share in the property of the firm.

3.4.2 Duties of Partners

A partner may have two types of duties:-

- a) Those envisaged in the partnership contract, and
- b) Those prescribed in the Act

a) **Duties envisaged in the partnership contract:**

Partners may fix any duties. These may be expressed or implied by a course of dealing. But these duties should not violate the Act or the general principles of contract.

b) **Duties prescribed in the Act:**

The following statutory duties are implied:

- i) ***Duty of Good Faith (Section 9):*** Partners are bound to carry on the business of the firm to the greatest common advantage, to be just and faithful to each other, and to render true accounts and full information of all things affecting the firm to any partner or his legal representative. Duty to be just and faithful is a mutual duty on which the foundation of partnership stands.
- ii) ***Duty to Indemnify for Loss Caused by Fraud (Section 10):*** Every partner is bound to indemnify firm for any loss caused to it by his fraud in the conduct of the business of the firm.
- iii) ***Duty of Due Diligence [Section 12(b) and 13(a)]:*** Every partner is bound to attend diligently to the business of the firm and in the absence of any agreement to the contrary, he is not entitled to receive any remuneration.
- iv) ***Duty to Proper use of Property (Section 15):*** Every partner must hold and use the partnership property exclusively for the purpose of firm's business.
- v) ***Duty to account for profit and pay it to the firm [Section 16(a)]***
 - If a partner derives any profit for himself from any transaction of the firm, or from the use of the property or business connection of the firm or the firm name, he shall account for that profit and pay it to the firm;
 - If a partner carries on any business of the same nature as and competing with that of the firm, he shall account for and pay to the firm all profits made by him in that business.

- vi) **Duty not to Compete [Section 16(b)]:** A partner must not compete with the firm, without the consent of the other partners. Any profits made by such unauthorised competition can be claimed by the firm.
- vii) A partner who is guilty of willful neglect in the conduct of the business and the firm suffers loss in consequence, is bound to make compensation to the firm and other partners. [Section 13(f)]
- viii) No partner can assign or transfer his partnership interest to any other person, so as to make him a partner in the business. But a partner may assign the profits and share in the partnership assets. But the assignee or transferee will have no right to ask for the accounts or to interfere in the management of the business; he would be entitled only to share the actual profits. On dissolution of the firm, he will be entitled to the share of the assets and also to accounts but only from the date of dissolution. (Section 29)
- ix) Every partner is bound to act within the scope of his actual authority. If he exceeds his authority, he shall compensate the other partners for loss unless they ratify his act.

3.5 RELATION OF PARTNERS TO THIRD PARTIES

There are two sets of relationships. **First**, the relationship between the partners themselves which are implied relations due to the rights and duties arising out of contracting partnership. **Second**, relations of partners to third parties consist of the business carried on by one or all members of the firm in the name to the firm. They are responsible as a firm to their customers.

3.5.1 Partners as Agents

As already discussed every partner is both a principal and an agent. Thus, the general law of agency is incorporated into the law of partnership. The acts of every partner which is done to carry on, in the usual way, the business of the kind carried on by the firm, bind the firm and his partners unless:

- i) The partner so acting has no authority to act for the firm in that matter; and
- ii) The person with whom he is dealing knows that he has no authority; or
- iii) Does not know or believe him to be a partner.

3.5.2 Authority of a Partner

The authority of a partner means the capacity of a partner to bind the firm by his act. This authority may be express or implied.

- i) **Express Authority:** The authority is said to be express when it is given by words, spoken or written. The firm is bound by all acts of a partner done within the scope of his express authority even if the acts are not within the scope of the partnership business.
- ii) **Implied Authority:** The authority which is inferred from the conduct of the parties, nature of business, circumstances, customs and usage are said to be implied authority. Sections 19 and 22 contain provisions regarding the scope

of the implied authority of a partner. The implied authority is subject to the following conditions: (1) the act done must relate to the “normal business” of the firm; (2) the act must be done in the usual way or in the ordinary course of business, and; (3) the act must be done in the name of the firm.

The general scope of implied authority is that it is limited to all that is just necessary to do the business and doesn’t extend beyond that. Following acts are under the implied authority:

- a) To sell firm’s goods;
- b) To purchase goods for the firm;
- c) To accept any payment of debts due to the firm; and
- d) To engage and discharge employees.

In a Trading Firm (one which carries on business of buying and selling goods), a partner has the following additional powers:

- a) To borrow money on the firm’s credit and to pledge the firm’s goods for that purpose;
- b) To accept, make and issue negotiable instruments in the firm’s name; and
- c) To employ a solicitor or attorney on behalf of the firm

It is, however, open to the partners by means of an express contract to extend or limit the implied authority, but third parties will be bound by such limitations only when they have notice of such curtailment.

All partners are liable jointly and severally for all acts or omissions binding on the firm including liabilities arising from contracts as well as torts (Section 25). This is known as the liability of partners for the acts of the firm. But in order that an act done may be an act of the firm and, therefore, binding on the firm, it is necessary that the partner doing the act on behalf of the firm must have done that act in the name of and on behalf of the firm and not in his personal capacity. The act must have been done in the ordinary course of the business of the firm. [Sections 19(1) and 22]

Activity 3

Choose the right answer.

- a) Which of the following acts are included in the implied authority of a partner?
 - i) To borrow money for the purpose of firm.
 - ii) To enter into partnership on behalf of firm
- b) The implied authority of a partner of the firm does empower him to:
 - i) Enter into partnership on behalf of the firm.
 - ii) act expressing or implying an intention to bind the firm
- c) If a partner commits fraud in the conduct of the business of the firm:
 - i) He shall indemnify the firm for any loss caused to it by his fraud
 - ii) He is liable to the third parties

- d) Which of the following is the right of partner i.e., which he cannot claim as a matter of right?
 - i) Right to take part in business
 - ii) Right to receive remuneration.
- e) Partners are bound to carry on the business of the firm-
 - i) To the greatest common advantage
 - ii) For the welfare of the society

3.6 RECONSTITUTION OF FIRM

A firm is said to be reconstituted, when there is change in the composition of the partnership. The reconstitution of the firm takes place on account of admission, death, retirement, expulsion, if partnership carries on business other than the business for which it was originally formed or when the partnership business is carried on after the expiry of the term fixed for the purpose. The reconstitution involves changes in the rights and liabilities of partners. How does the law cope with change concerning partnership is made amply clear in the following sections of the law.

3.6.1 Admission of a Partner

As discussed earlier, subject to a contract between partners and to the provisions regarding minors in a firm, no new partners can be introduced into a firm without the consent of all the existing partners.

As a general rule, an incoming partner is not liable for the debts incurred before he joined the firm as a partner [Section 31(2)]. The incoming partner may, however, assume liability for past debts by novation, i.e., by a tripartite agreement between (i) the creditor of the firm, (ii) the partners existing at the time the debt was incurred, and (iii) the incoming partner.

3.6.2 Retirement of a Partner

A partner can retire from the firm i) with the consent of all the other partners; or ii) in accordance with the expressed agreement among the partners; or iii) by giving a written notice to all the partners of his intention to retire, if partnership is at will.

An outgoing partner remains liable for the partnership debts contracted while he was a partner. He may, however, be discharged by novation, i.e., by an agreement between himself, the new firm and the creditors. He may also continue to be liable after retirement if he allows himself to be held out as a partner, e.g. by allowing his name to remain the firm name. To protect himself from his liability, he should give express notice of his retirement to the persons who were dealing with the firm before his retirement or give public notice in the manner as laid down in Section 72 of the Act, that is to say, by publishing it in the Official Gazette and in at least one vernacular newspaper where the firm carries on the business. [Section 32(3)]

3.6.3 Expulsion of a partner

A partner can be expelled only if i) the power of expulsion exists in a contract between the partners; ii) the power has been exercised by a majority of the partners; and iii) it has been exercised in good faith.

If all these conditions are not present, the expulsion is not deemed to be in bona fide interest of the business of the firm.

The rights and liabilities of the expelled partner are same as that of a retired partner.

3.6.4 Death or Insolvency

The estate of a partner who dies, or who becomes insolvent, is not liable for partnership debts contracted after the date of the death or insolvency. It will, however, be liable for debts incurred before death or insolvency. (Sections 34 and 35).

Activity 4

Fill in the blanks:

- a) A new partner can be admitted in the firm with the consent of _____.
- b) Admission, Retirement, Expulsion or death of a partner leads to _____.
- c) A partner can retire by _____ if partnership is at will.
- d) The estate of a partner who dies, or who becomes insolvent, is not liable for partnership debts contracted _____ the date of the death or insolvency.

3.7 DISSOLUTION

According to Section 39, “The dissolution of partnership between all the partners of a firm” is called the “Dissolution of the Firm”.

The law of Partnership makes a distinction between the “*dissolution of partnership*” and “*dissolution of firm*”. Where the relation between all the partners come to an end, it is a dissolution of the firm (Section 39). Where there is an extinction of relationship between some of the partners only, it is a dissolution of partnership. So the dissolution of a partnership may or may not include the dissolution of the firm, but the dissolution of the firm necessarily means the dissolution of the partnership as well.

Dissolution of Partnership

The dissolution of partnership takes place (even when there is no dissolution of the firm) in the following circumstances:

- a) On the expiry of the fixed term for which the partnership was formed. [Section 42(a)]
- b) On the completion of the adventure. [Section 42(b)]
- c) On the death of a partner. [Section 42(c)]
- d) On the insolvency of a partner. [Section 42(d)]

- e) On the retirement of a partner. [Section 42(e)]

In all the above cases, the remaining partners may continue the firm in pursuance of an agreement to that effect. If they do not continue then the dissolution of the firm takes place automatically.

Dissolution of the Firm

In the following cases there is necessarily a breaking up or extinction of the relationship between all the partners of the firm, and closing up of the business:

- a) **By mutual agreement:** A firm may be dissolved where all the partners agree that it shall be dissolved. (Section 40)
- b) **By the insolvency of all the partners but one:** If all the partners or except one all the partners become insolvent, the firm must come to an end, as a partnership firm with one partner cannot continue. [Section 41(a)]
- c) **By business becoming illegal:** If the business of the firm becomes illegal because of some subsequent events, such as change of law, it is automatically or compulsorily dissolved by the operation of law. [Section 41(b)]
- d) **By notice of dissolution:** Where the partnership is at will, the firm may be dissolved at any time, by any partner giving notice in writing of his intention to dissolve the firm, to all the other partners. The dissolution will take place from the date mentioned in the notice or, if no such date is mentioned, as from the date of the communication of the notice. (Section 43)

Modes of Dissolution of a firm (section 40 to 44)

The dissolution of partnership firm may be in any of the following ways:

- 1) Dissolution without the order of the court or voluntary dissolution.
- 2) Dissolution by the court (section 44)

1) Dissolution without the Order of the Court or Voluntary Dissolution:

It consists of following four types:

- i) **Dissolution by Agreement (Section 40):** A firm may be dissolved with the consent of all the partners or in accordance with a contract between the partners.
- ii) **Compulsory dissolution (Section 41):** A firm is compulsorily dissolved by the:
 - a) adjudication of all the partners or of all the partners but one as insolvent; or
 - b) happening of any event which makes it unlawful for the business of the firm to be carried on or for the partners to carry it on in partnership.

However, it should be noted that when more than one separate venture or undertaking is carried on by the firm, the illegality of one or more shall not of itself cause the dissolution of the firm in respect of its lawful adventures and undertakings.

- iii) **Dissolution on the happening of certain contingencies (Section 42):** Subject to contract between the partners, a firm can be dissolved on the happening of any of the following contingencies-

- a) Where firm is constituted for a fixed term, on the expiry of that term
 - b) Where the firm is constituted to carry out one or more adventures or undertaking, then by completion thereof
 - c) By the death of a partner, and
 - d) By the adjudication of a partner as an insolvent.
- iv) ***Dissolution by notice of partnership at will (Section 43):*** Where the partnership is at will, the firm may be dissolved by any partner giving notice in writing to all the other partners of his intention to dissolve the firm.

The firm is dissolved as from the date mentioned in the notice as the date of dissolution or, if no date is so mentioned, as from the date of the communication of the notice.

2) ***Dissolution of the Firm through Court***

As per Section 44, at the suit of a partner, the Court may order dissolve a firm on any of the following grounds, namely:

- a) ***If a partner becomes of unsound mind:*** As the insanity of a partner does not automatically dissolve the firm, in such a case the suit for the dissolution of the firm may be brought by other partners or by next friend of partner who has become of unsound mind. In either case the Court may order dissolution which will take effect from the date of the order.
- b) ***Permanent incapacity of a partner:*** Where a partner has become permanently incapable of performing his duties as a partner, e.g., he becomes blind, paralytic, etc., the Court may, at the instance of any of the other partners, order the dissolution of the firm.
- c) ***Misconduct of a partner affecting the business:*** Where a partner, other than the partner suing, is guilty of conduct which is likely to affect prejudicially the carrying on of the business, the Court may dissolve the firm at the instance of any of the other partners. Gambling by a partner or conviction of a partner for travelling without ticket would be sufficient ground for dissolution.
- d) ***Persistent disregard of partnership agreement by a partner:*** Where a partner, other than the partner suing, willfully or persistently commits breaches of the partnership agreement relating to the management of the affairs of the firm or the conduct of its business; or otherwise so conducts himself in matters relating to the business that it is not reasonably practicable for the other partners to carry on the business in partnership with him; the Court may order dissolution at the instance of the other partners.
- e) ***Transfer of interest or share by a partner:*** A partner cannot assign his interest so as to introduce a new partner into the firm. Where a partner has transferred the whole of his interest to a third person or where his interest has been attached under a decree or sold under a process of law, the other partners may sue for dissolution.

- f) **Business working at a loss:** if the Court is satisfied that the business of the firm cannot be carried on except at a loss, it may order for dissolution.
- g) **Any just and equitable:** As the grounds mentioned are not exhaustive, the Court may dissolve a firm on any other ground if it is satisfied that it would be just and equitable to dissolve the firm. The Court may order dissolution where the sub-stratum of the partnership firm has gone or where there is a complete deadlock and destruction of confidence between the partners [re. Yenidjee Tobacco Co. Ltd. (1916) 2 Ch. 426].

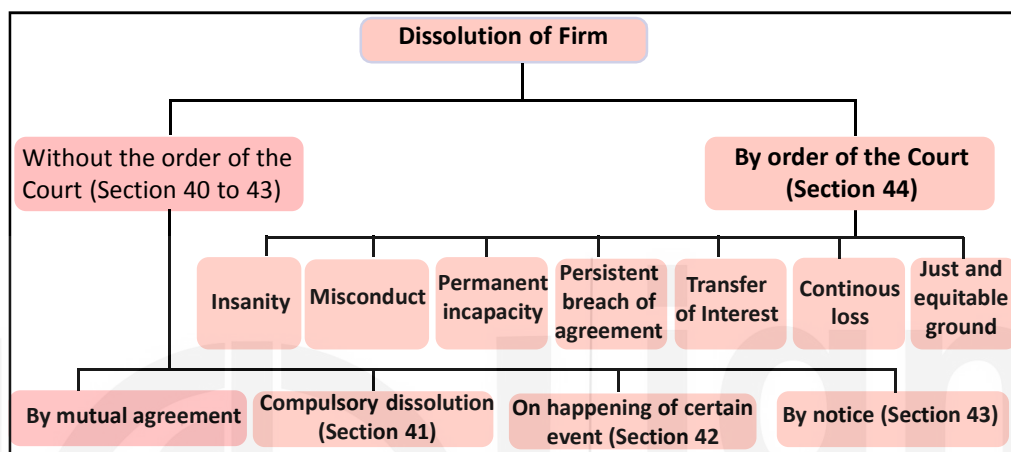


Figure 3.1: Different Forms of Dissolution of a Firm

Effect of Dissolution:

After dissolution, the rights and obligations of partners continue in all things necessary for the winding up of the business. The partners may complete unfinished transactions. But this authority is only for the winding up of the affairs of the firm and not for new transactions. These rights and liabilities are discussed below:

Rights of Partners on Dissolution:

Right of partners to have business wound up after dissolution (section 46): On the dissolution of a firm every partner or his representative is entitled, as against all the other partners or their representative, to have the property of the firm applied in payment of the debts and liabilities of the firm, and to have the surplus distributed among the partners or their representatives according to their rights. This lien can be enforced by injunction forbidding unfair distribution. (Section 46)

Right to Return of Premium (Section 51): To buy entry into an existing firm, a new partner sometimes has to pay a premium to the existing partners in addition to any investment of capital. On dissolution, he is entitled to demand the return of a proportion of the premium if the partnership was for a fixed term and was dissolved before the expiry of that term, unless dissolution was caused by (i) agreement, or (ii) misconduct of the party seeking return of the premium, or (iii) death of a partner. (Section 51)

Rights Where Partnership Contract is Rescinded for Fraud Or Misrepresentation (Section 52): Where a contract creating partnership is rescinded on the ground of fraud or misrepresentation of any of the parties thereto, the

party entitled to rescind is, without prejudice to any other right, entitle - (a) to a lien on, or right of retention of, the surplus of the assets of the firm remaining after the debts of the firm have been paid, for any sum paid by him for the purchase of a share in the firm and for any capital contributed by him; (b) to rank as a creditor of the firm in respect of any payment made by him towards the debts of the firm; and (c) to be indemnified by the partner or partners guilty of fraud or misrepresentation against all the debts of the firm.

Right to Restrain from Use of Firm-Name or Firm-Property (Section 53): After a firm is dissolved, every partner or his representative may, in the absence of a contract between the partners to the contrary, restrain any other partner or his representative from carrying on a similar business in the firm-name or from using any of the property of the firm for his own benefit, until the affairs of the firm have been completely wound up : Provided that where any partner or his representative has brought the goodwill of the firm, nothing in this section shall affect his right to use the firm-name.

Partners may, upon or in anticipation of the dissolution of the firm, make an agreement that some or all of them will not carry on a business similar to that of the firm within a specified period or within specified local limits and notwithstanding anything contained in section 27, of the Indian Contract Act, 1872, such agreement shall be valid if the restrictions imposed are reasonable.

3.8 LIMITED LIABILITY PARTNERSHIP ACT, 2008

Limited Liability Partnership (LLP) has been introduced in India by way of Limited Liability Partnership Bill on 12th December, 2008; passed by both the houses of Parliament and assented by the President of India on 7th January, 2009 and called as the Limited Liability Partnership Act, 2008. It extends to whole of India. It fundamentally changes the nature of partnership from that of a free and voluntary entity to a legal one. However, the LLP, Act does not harm the existence Partnership Act; it remains as it is , and both are independent of each other.

The LLP Act, 2008 has 81 sections and 4 schedules.

The ***First Schedule*** deals with mutual rights and duties of partners, as well as limited liability partnership and its partners where there is absence of a formal agreement with respect to them.

The ***Second Schedule*** deals with conversion of a firm into LLP.

The ***Third Schedule*** deals with conversion of a private company into LLP.

The ***Fourth Schedule*** deals with conversion of unlisted public company into LLP.

The Ministry of Corporate Affairs and the Registrar of Companies (ROC) are entrusted with the task of administrating the LLP Act, 2008. The Central Government has the authority to frame the Rules with regard to the LLP Act, 2008, and can amend them by notifications in the Official Gazette, from time to time.

Definitions

Limited Liability Partnership means a partnership formed and registered under this Act. [Section 2(n)]

Accordingly—

- 1) A limited liability partnership is a body corporate formed and incorporated under this Act and is a legal entity separate from that of its partners.
- 2) A limited liability partnership shall have perpetual succession.
- 3) Any change in the partners of a limited liability partnership shall not affect the existence, rights or liabilities of the limited liability partnership.

Features of LLP

Body corporate: LLP is a body corporate formed and incorporated under this Act.

Separate Legal Entity: The LLP is a legal entity separate from that of its partners. Therefore, LLP is liable to the full extent of its assets but liability of the partners is limited to their agreed contribution in the LLP. In other words, creditors of LLP shall be the creditors of LLP alone.

Perpetual Succession: Any change in the partners of a LLP shall not affect the existence, rights or liabilities of the LLP [Section 2(1)(d)].

Limited Liability: The liability of the partners is limited to their agreed contribution in the LLP. Such contribution may be of tangible or intangible nature or both.

Minimum and Maximum number of Partners: Every LLP shall have at least two partners and shall also have at least 2 individuals as designated partners, of whom at least one shall be resident in India. There is no maximum limit on the partners in LLP.

If in LLP, all the partners are bodies corporate or in which one or more partners are individuals and bodies corporate, at least two individuals who are partners of such LLP or nominees of such bodies corporate shall act as designated partners.

Example: A LLP by the name SMY LLP has three partners namely 1. SI Limited, 2. MIS Limited, 3. YI Private Limited. This will not be considered for registration because the requirement for LLP is to have 2 individual members as partners apart from the body corporate. Accordingly, the said SMY LLP must consist of at least five partners; namely the three body corporates and 2 individual members, to constitute the LLP and the two individuals need to be treated as designated partners.

Third party liability: unlimited to all partners.

Artificial Legal Person: LLP is an artificial legal person because it is created by a legal process and is clothed with all rights of an individual. LLP is invisible, intangible, immortal (it can be dissolved by law alone) but not fictitious because it really exists.

Rights and Duties: Mutual rights and duties of the partners within a LLP are governed by an agreement between the partners. In the absence of any such agreement, the mutual rights and duties shall be governed by the provisions of the LLP Act, 2008.

Mutual Agency: Every partner of a LLP, for the purpose of the business of LLP, is the agent of the LLP, but not of other partners (Section 26). In other words, no

partner is liable on account of the independent or un-authorized actions of other partners, thus individual partners are shielded from joint liability created by another partner's wrongful business decisions or misconduct.

Example: The professionals like Engineering consultants, Legal Advisors and Accounting Professional are afraid of entering into business due to unlimited liability. Hence the LLP partnership Act provides an avenue for these professionals to Limited Liability Partnership firms which restricts their liability to the agreed amount. This has encouraged Professionals to form LLP.

Management of Business: The partners in the LLP are entitled to manage the business of LLP. But only the designated partners are responsible for legal compliances.

Business for Profit Only: The essential requirement for forming LLP is carrying on a lawful business with a view to earn profit. LLP cannot be formed for charitable or non-economic purpose.

Common Seal: Any LLP being an artificial person can act through its partners and designated partners. LLP may have a common seal, if it decides to have one [Section 14(c)]. Thus, it is not mandatory for a LLP to have a common seal. It shall remain under the custody of some responsible official and it shall be affixed in the presence of at least 2 designated partners of the LLP.

Foreign LLPs: Foreign LLP can become a partner in an Indian LLP. Section 2(1)(m) defines foreign limited liability partnership "as a limited liability partnership formed, incorporated, or registered outside India which established as place of business within India".

Who can be a Partner?

"Partner" in relation to LLP, means any person who becomes a partner in the LLP in accordance with the LLP agreement. Section-5 lays down that -

Any individual or body corporate may be a partner in a LLP. Provided that an **individual shall not be capable** of becoming a partner, if —

- a) he has been found to be of unsound mind by a Court of competent jurisdiction and the finding is in force;
- b) he is an undischarged insolvent; or
- c) he has applied to be adjudicated as an insolvent and his application is pending.

Body Corporate shall exclude:

- a corporation sole, means a public office established by the Act of Parliament, a sole officeholder;
- a co-operative society; and
- any other body corporate not being a company as defined under Companies Act, 2013.
- NBFCs are prohibited to be partner of LLPs.

Following can be partners in LLP:

- A company incorporated outside India.
- A LLP can become a partner in another LLP

- A trust cannot become partner in LLP. However, trustee can become a partner of LLP in his “individual capacity” but not in a representative capacity of trust
- Similarly, an HUF cannot become a partner but Karta can in his “individual capacity” but not in a representative capacity of HUF

Liability of Partners:

Nature & extent of liability of a partner of an LLP: Every partner of an LLP would be, for the purpose of the business of the LLP, an agent of the LLP but not of the other partners. Liability of partners shall be limited except in case of unauthorized acts, fraud and negligence. But a partner shall not be personally liable for the wrongful acts or omission of any other partner. An obligation of the LLP whether arising in contract or otherwise, is solely the obligation of the LLP. The liabilities of LLP shall be met out of the property of the LLP.

Liability of a Partner upon reduction of minimum number of members in an LLP: If at any time the number of partners of LLP is reduced below two and the LLP carries on business for more than six months while the number is so reduced, the person, who is the only partner of the LLP during the time that it so carries on business after those six months and has the knowledge of the fact that it is carrying on business with him alone, shall be liable personally for the obligation of LLP incurred during that period.

Liability of ‘partner by holding out : The Act provides that any person (not being a partner in any LLP), who by words spoken or written or by conduct, represents himself, or knowingly permits himself to be represented as a partner in a LLP (known as ‘partner by Holding out’) is liable to any person who has on the faith of any such representation given credit to the LLP, whether the person representing himself or represented to be a partner does or does not know that the representation has reached the person so giving credit.

It has further been provided that where any credit is received by the LLP as a result of such representation, the LLP shall, without prejudice to the liability of the person so representing himself or represented to be a partner, be liable to the extent of credit received by it or any financial benefit derived thereon.

The provisions have also been made in the Act to provide that where after a partner’s death the business is continued in the same LLP name, the continued use of that name or of the deceased partner’s name as a part thereof shall not of itself make his legal representative or his estate liable for any act of the LLP done after his death.

Designated Partners (Section 7)

A designated partner means any partner designated as such u/s 7. Appointment of at least two ”Designated Partners” is mandatory for all LLPs. “Designated Partners” shall also be accountable for regulatory and legal compliances, besides their liability as ‘partners, per-se’.

- 1) Every LLP must have atleast two individuals as Designated Partners and at least one of them shall be a resident of India (Resident means a person who stayed in India in Previous year not less than 182 days).
- 2) In a LLP where all the partners are bodies corporate or where one or more partners are individuals and bodies corporate, at least two individuals who

are partners of such LLP or nominees of such bodies corporate shall act as designated partners.

- 3) U/s 7(2) one become the designated partner if the incorporation document
 - Specifies such person/s; or
 - States that each of the partners from time to time of a LLP is to be a designated partner, then every partner shall be a designated partner;
- 4) Any partner may become the designated partner or cease to be a designated partner, in accordance with the LLP agreement;
- 5) An Individual shall not become a designated partner unless he has given his prior consent ;
- 6) Every LLP shall file with ROC the particulars of every Individual who has given his consent to act as designated partner, within 30 days of his appointment;
- 7) An individual eligible to be a designated Partner must satisfy the condition and requirement as may be prescribed.
- 8) A person shall not be capable of being appointed as a designated partner of LLP, if he
 - At any time within the preceding five years, has been adjudged insolvent;
 - Suspends at any time within the preceding five years, payment to his creditors and has not, at any time in preceding five year, made a composition with them;
 - Has been convicted for any offence involving moral turpitude and sentenced to imprisonment for not less than six months;
 - Has been convicted by Court for an offence involving section 30 of the LLP Act;
- 9) Every designated partner must obtain Designated Partner Identification Number (DPIN) from Central Government and provision of Section 153 to 159 of the Companies Act, 2013;
 - If a person holds both DIN and DPIN then his DPIN shall stand cancelled and DIN shall be sufficient for being appointed as Designated Partner
 - Every designated Partner shall in the event of any changes as stated in Form 10 or DIR-3, intimate the Central Government in Form DIR-6 under Companies (Appointment and Qualification of Directors) Rules, 2014; {Rule 10(4)(i)}
 - The concerned designated partner shall fill-in the relevant changes to the LLP on which he is a designated partner within 30 days of such changes; {Rule 10(4)(ii)}

Liability of a Designated Partner (Section 8)

Unless expressly provided otherwise in this Act, a designated Partner shall be-

- a) Responsible for performing all acts, matters and things including filing of any document, return, statement and the like report as mentioned under this Act and specified in the LLP agreement; and

- b) Liable to all penalties imposed on the LLP for contravention of those provisions.

Change in Designated Partners (Section-9)

- A LLP may appoint a designated partner within 30 days of a vacancy arising for any reason and provision of section 7 (4) and (5) shall apply in respect of such new designated partner;
- If no Designated Partner appointed within 30 days of vacancy or if number of designated partner at any time reduced below the two then all partner shall deemed to be a designated partner.
- Section 64 (b) of the LLP Act, provides that if number of partners reduced below the two and LLP continues, as same, for more than 6 months then the LLP may be wound up by the Tribunal.

3.9 DIFFERENCES WITH OTHER FORMS OF ORGANISATION

LLP and Partnership:

- LLP is regulated by The Limited Liability Partnership Act, 2008 where-as Partnership firm by The Indian Partnership Act, 1932.
- LLP is a body corporate where as Partnership is not.
- LLP is a separate legal entity where as partnership is not.
- LLP is created by a legal process called registration under the LLP Act, 2008, where as the partnership is created by an agreement between the partners
- Registration is mandatory for LLP where as it is voluntary for partnership.
- LLP can sue and be sued in its own name. Only the registered partnership firm can sue the third parties
- LLP has perpetual succession. The death, insanity, retirement or insolvency of the partner(s) does not affect its existence, where as it is not so in partnership
- Name of the LLP to contain the word limited liability partners (LLP) as suffix. No guidelines for partnership.
- Liability of each partner limited to the extent to agreed contribution except in case of willful fraud. Liability of each partner is unlimited in partnership.
- Each partner can bind the LLP by his own acts but not the other partners. However, in partnership each partner can bind the firm as well as other partners by his own acts.
- Every LLP should have at least two designated partners and at least one of them shall be resident in India. There is no provision for such partners under the Partnership Act, 1932.
- LLP may have its common seal as its official signatures. No such concept in partnership.
- In LLP only designated partners are responsible for all the compliances and penalties under the Act where as in partnership all partners are responsible for all the compliances and penalties under the Act.

- Partnership firm is not required to file any annual document with the Registrar of firms. However, LLP is required to file -Annual statement of accounts, Statement of solvency, Annual return with the registration of LLP every year.
- Foreign nationals can become a partner in a LLP. However, it is not so in partnership.
- Minor can be admitted to the benefits of the partnership with the prior consent of the existing partners, but it is not so in the case of LLP.

LLP and Company:

- LLP is regulated by the LLP Act, 2008, and the companies by the Companies Act, 2013.
- The persons who contribute to LLP are known as partners of the LLP. The persons who invest the money in the shares are known as members of the company.
- The internal governance structure of a LLP is governed by contract agreement between the partners. The internal governance structure of a company is regulated by statute (i.e., Companies Act, 2013).
- Name of the LLP to contain the word “Limited Liability partnership” or “LLP” as suffix. Name of the public company to contain the word “limited” and Pvt. Co. to contain the word “Private limited” as suffix.
- Minimum – 2 members. Maximum – No such limit on the members in the LLP Act. The members of the LLP can be individuals/or body corporate through the nominees. Private company: Minimum – 2 members Maximum 200 members Public company: Minimum – 7 members Maximum – No such limit on the members. Members can be organizations, trusts, another business form or individuals.
- Liability of a partners is limited to the extent of agreed contribution except in case of intention is fraud. Liability of a member is limited to the amount unpaid on the shares held by them.
- The business of the LLP is managed by the partners including the designated partners authorized in the agreement. The affairs of the company are managed by Board of Directors elected by the shareholders.
- Minimum 2 designated partners for LLP, Pvt. Co. – 2 Directors, Public co. – 3 Directors.

3.10 ADVANTAGES AND DISADVANTAGE OF LLP

Advantages of LLP:

- **Easy to form:** less legal and procedural requirements
- **Low Cost of formation:** The minimum fees of incorporation is as low as Rs 800 and maximum is Rs 5600.
- **Separate legal entity:** LLP & its partners are distinct from each other
- **Perpetual existence:** The LLP shall continue to exist till its wound up in accordance with the provisions of the relevant law

- **Limited Liability:** liability is limited to extent of his contribution. Personal assets of the partners are exposed in case of fraud
- **Flexibility in management:** The LLP Act does not regulate the LLP to large extent rather it gives freedom to partners to decide the way they want to run and manage the LLP, in form of LLP Agreement.
- No requirement of minimum capital contribution
- No restrictions as to maximum number of partners
- A partner cannot bind the other partner for his act.
- Easy to dissolve or wind-up
- No requirement to maintain statutory records except Books of Accounts

Disadvantages of LLP:

- The documents filed through the Ministry of Corporate Affairs portal are public documents and any person can assess them by paying a nominal fee
- LLP cannot raise funds from Public, it can either borrow debt from financial institutions or via a loan from partners.
- Any act of the partner without the knowledge of other partners may bind the LLP
- No separation of Management from owner.

3.11 INCORPORATION OF LLP

Pre-requisites for Incorporating a LLP

- Minimum two partners (Individual or body corporate).
- Minimum two designated partners who are individuals and at least one of them should be resident in India.
- Digital signature certificate
- LLP Name
- LLP Agreement
- Registered office

LLP incorporation Process

The Ministry of Corporate Affairs (MCA) vide its Notification dated 18th September, 2018 made major amendments in the rules for incorporation of LLP vide Limited Liability Partnership (Second Amendment) Rules, 2018, which came into force from 2nd October, 2018.

The highlights of the amended LLP incorporation process includes the introduction of specified LLP-RUN services (similar to RUN service for Company Incorporation) for Reservation of Name for the proposed LLP, Form FiLLiP i.e. Form for Incorporation of LLP. Form FiLLiP is similar to form SPiCe for Company Incorporation.

STEP – I: Procure Digital Signature Certificate

STEP – II: Apply for Name Approval

STEP – III Preparation of Documents for Incorporation of LLP:

STEP – IV: Fill the Information in Form: [FiLLiP]

STEP – V: Certificate of Incorporation

STEP – VI: Apply for PAN and TAN

STEP – VII: Preparation of LLP Agreement

Step 1: Procure Digital Signature Certificate (DSC)

The first step towards registering LLP is to procure the digital signatures with validity of 2 years for the designated partners. A digital signature is must because every form is filed online with the Ministry of Corporate Affairs and each requires to be signed digitally by the applicants and partners of the LLP. The DSC is associated with the PAN card of the application.

Digital signatures required can be obtained from certified government agencies, such as National Informatics Center, IDRBT Certifying Authority, E-MUDHRA, CDAC and NSDL. The cost of acquiring a DSC will be according to the certifying agency that the applicant has applied for.

Step 2: Apply for Name Approval

To register a proposed LLP, the applicant needs to get a Limited Liability Partnership-Reserve Unique Name (LLP-RUN) that can be processed at the Central Registration Centre. However, before citing or quoting the name, it is always advisable to check from the Ministry of Corporate Affairs (MCA) portal for a free name. The new process requires the applicants to file the web form named RUN-LLP (Reserve Unique Name – Limited Liability Partnership). RUN-LLP replaces the old form LLP Form 1. The new form has been simplified that requires information related to the desired name, its significance and other basic details.

The application can be made with maximum 2 names in preference order providing their significance. The names must comply with the provisions for name reservation. If none of the names is approved by the MCA, another chance is provided to apply two more names. The government fees for RUN, as per Register Office Fees Rules, shall be Rs 1,000. DSC and DIN are not required for filing of RUN form for reservation of name but account of MCA portal is mandatory. The name allotted under LLP-RUN will be reserved for a period of 90 days. If the LLP registration application is not filed in given period, the name will expire and it can be reserved through new application.

Step 3: Preparation of Documents for Incorporation of LLP

After approval of name, LLP applicant is required to prepare the following documents:

- Proof of office address (Conveyance/Lease Deed/Rent Agreement etc. along with rent receipts)
- NOC from owner of the property
- Copy of utility bills (not older than 2 months)
- Subscription sheet including consent
- In case, a designated partner does not have a DIN, it is mandatory to attach: Proof of identity and residential address of the subscribers

- All the DPs should have digital signature
- Detail of LLP(s) and/or Company(s) in which partner or designated partner is a director/partner
- Copy of approval in case the proposed name contains any word(s) or expression(s) which requires approval from Central Government.

Step 4: Fill the Information in Form: [FiLLiP]

Once all the above mentioned documents/ information are available. Applicant has to fill the information in the e-form “ FiLLiP” (Form for incorporation of Limited Liability Partnership). This is a major change in the new process. FiLLiP replaces the earlier, form 2.

Earlier if a Person wants to incorporate LLP then s/he had to apply separately for the DIN, Approval of the Name availability, registered office address, etc. But this form is a single window for Incorporation of LLP and it can be used for the following purposes:

- Application of DIN
- Application for Availability of Name
- No need to file separate form for address of registered office

Only 2 DPIN/DIN can be allotted through FiLLiP. In case, there are more than 2 DPs or DPs are to be changed; the respective partners is required to obtain it by filing DIR-3 after incorporation.

The e-form is to be attested by the partners through DSC and certified by the practicing Chartered Accountant or Company Secretary or Cost & Works Accountant.

The application will be processed for approval by Central Registration Centre (CRC). If the registrar finds it necessary to call for further documents or information, he may do so by directing for re-submission within 15 days. Another opportunity of re-submission maybe provided after re-examination of application, which again has 15 days period. It is provided that the total period for re-submission of documents shall not exceed 20 days in total.

Step 5: Certificate of Incorporation

Once the Registrar approves all the forms and documents, the Certificate of Incorporation (CoI) is issued in form 16 along with DPIN/DIN allotted to the Designated Partners. CoI will also consist of the Limited Liability Partnership Identification Number (LLPIN). Registrar of Companies (ROC) assigns a Limited Liability Partnership Identification Number (LLPIN) for every LLP which is registered. The date of CoI will be the date of LLP incorporation since when it has come into legal existence. LLP is now entitled to commence business in its name. The certificate of incorporation shall be the conclusive evidence that the limited liability partnership is incorporated by the name specified therein.

Step 6: Apply for PAN and TAN

Soon after getting the incorporation certificate, the application for PAN and TAN is required to be made separately for LLP through offline or online mode. The applications are made directly to the Income Tax Department and also processed

by it. The applications are made in forms 49A and 49B respectively with Certificate of Incorporation as supporting proof.

Step 7: Drafting and Filing LLP Agreement

The next step is to draft LLP Agreement and other documents for registration. An LLP agreement is essential, as it determines the mutual rights and duties amongst the partners, and between the LLP and the partners. The agreement must be filed with MCA within 30 days of date of incorporation. The delay leads to penalty of Rs. 100/- per day till the date of actual filing.

LLP Agreement contains, the name of LLP, name and address of partners and designated partners, business object, place of business and other details of LLP. Other clauses will be form of contribution and interest on contribution, profit sharing ratio, rights and duties of partners in case of admission, resignation, retirement, cessation and expulsion, proposed business, and rules for governing the LLP.

Once the LLP Agreement is reviewed and agreed upon by the partners, it will be executed by payment of stamp duty as applicable in the state where the registered office of the LLP is situated. Then with signature by partners and attestation by the witnesses, the agreement will be executed.

Activity 5

State whether the following statement are true or false.

- a) LLP is a separate legal entity_____
- b) LLP should be for profit or charitable business_____
- c) LLP is registered with Registrar of companies_____
- d) LLP can be converted into partnership_____
- e) An unlisted public company can be converted into LLP_____

3.12 SUMMARY

Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any one of them acting for all. Persons who have entered into partnership with one another are called individually '*partners*' and collectively '*a firm*', and the name under which the business is carried on is called the '*firm's name*'. The true test, in determining whether a partnership exists, is to see whether the relation of mutual agency i.e., principal and agent exists between the parties and not. Registration of firm is not mandatory but desirable as an unregistered firm suffers from a number of disabilities. Based on their conduct or profit sharing, partners can be of different types like; Actual, Active or Ostensible Partner, Sleeping or dormant partner, Nominal partner, Partner by estoppel or by holding out and so on.

A minor cannot be a partner but he can be admitted to the benefit of partnership with the consent of all. He has right to share profits but his liability is limited to the extent of his share and not personally liable for any losses.

The rights and duties of partners are governed by the agreement among them but

in case of absence of the same the provisions of the Partnership Act, are applicable. Unless there is contract to the contrary every partner is the joint owner of the property of the firm. Every partner binds the firm for the acts done within the scope of implied authority. A change in the constitution of a firm takes place on admission, retirement, expulsion, death or insolvency and transfer of interest.

The dissolution of partnership firm may be without the order of the court or voluntary dissolution or by the court. After dissolution, the rights and obligations of partners continue in all things necessary for the winding up of the business. The partners may complete unfinished transactions. But this authority is only for the winding up of the affairs of the firm and not for new transactions.

Limited Liability Partnership (LLP) is a body corporate with separate legal existence, perpetual succession and a common seal if it decides to have one. It is mandatory for a LLP to register with 'LLP' at the end of its name. The rights and duties of a partners and the partnership are governed by the agreement to the same. LLP should have at least two members and two individuals as its designated partners, one of whom should be resident in India. A firm, private company, unlisted public company can be converted into LLP.

3.13 SELF ASSESSMENT QUESTIONS

- 1) Define partnership.
- 2) Can a minor be admitted to partnership? If so, what are his rights and liabilities
- 3) What is partnership property?
- 4) Can a partner be expelled? If so, under what conditions?
- 5) Distinguish between dissolution of partnership and partnership firm.
- 6) Discuss the rights and liabilities of the partners on dissolution of the firm.
- 7) What is LLP? State the need of LLP How is it different from partnership?
- 8) Who is a designated partner?

3.14 FURTHER READINGS

- 1) Avtar Singh, 2018, *Introduction to Law of Partnership*, Eastern Book Company.
- 2) Bangia, R.K., 2019, *The Indian Partnership Act*, Allahabad law Agency.
- 3) Mitra, S.C., and Pradeep Kacker, 2019, *Law of Partnership in India*, Orient Publishing.
- 4) Jain, D.K., and Ishan Jain, 2021, *Bharat's Law and Procedure of Limited Liability Partnership*, Bharat Law House Pvt. Ltd.

UNIT 4 THE COMPANIES ACT, 2013

Objectives

After studying this unit, you should be able to:

- Understand the meaning of a company form of business
- Define a company and describe its characteristics and types
- Explain the stages in formation of a company
- Explain the meaning and importance of promoters
- Identify the need for Memorandum of Association and Articles of Association.
- Explain the meaning, importance, and contents of prospectus
- Explain the meaning of shares, share capital, debenture and deposits
- Understand how a company is managed and the role of Board of Directors
- Explain the meaning and mode of winding-up of company

Structure

- 4.1 Introduction
- 4.2 Formation of a Company
- 4.3 Principal Documents of a company
 - 3.3.1 Memorandum of Association
 - 3.3.2 Articles of Association
 - 3.3.3 Prospectus
- 4.4 Share and Loan Capital
 - 4.4.1 Share Capital
 - 4.4.2 Debentures
 - 4.4.3 Deposits
- 4.5 Company Management
- 4.6 Meetings
- 4.7 Winding Up of Companies
- 4.8 Summary
- 4.9 Self Assessment Questions
- 4.10 Further Readings

4.1 INTRODUCTION

The expansion in business needed an unlimited extent of capital. But the unlimited liability of the partners of the traditional partnerships under the Partnership Act, 1930 became a hurdle to meet the capital requirement. The corporate form of business helped to solve this problem through introduction of concept of limited liability. From formation to its winding up a company is governed by Companies Act. Apart from the Companies Act, the Parliament of India has enacted several other acts like, The Company Secretaries Act, The Competition Act, Monopolies & Restrictive Trade Practices Act, Indian Partnership Act, Sick Industries Act, etc., to have a control over the changing corporate world.

The Companies Act, 1956, which preceded the Companies Act, 2013, had numerous amendments; making it a complicated legislation with overlapping provisions. As it was becoming increasingly difficult to implement the Companies Act, 1956, the need to streamline the legislation and reduce regulation was recognized. As a result the Companies Act, 2013, was enactment which consolidates and amends the law relating to the companies.

The Companies Act, 2013, is divided into 29 chapters, containing 470 sections and seven schedules. A sizeable part of this Act is in the form of Companies Rules.

Applicability of the Companies Act, 2013:

The provisions of the Act apply to-

- 1) Companies incorporated under this Act or under any previous company law.
- 2) Insurance companies
- 3) Banking companies
- 4) Companies engaged in the generation or supply of electricity
- 5) Any other company governed by any special Act for the time being in force, and
- 6) Such body corporates which are incorporated by any Act for time being in force, and as the Central Government may by notification specify in this behalf.

In each of the case, from 2 to 6 above the provisions of the Act should not be in conflict with the provisions of other Act (Insurance Act, Banking Regulation Act, Electricity Act, etc.) by which the company is regulated; and if it is so, the provisions of respective Act/Acts to which it is governed and regulated by shall apply.

4.2 FORMATION OF A COMPANY

“Company means a company incorporated under this Act or under any previous company law”, Section 2(20) of the Companies Act, 2013.

This definition does not clearly bring out the meaning of the company. To define and understand the nature of a company the outside attempts and judicial decisions may be explored. Accordingly, ‘a corporation is an artificial being, invisible, intangible, existing only in contemplation of law. Being a mere creation of law, it possesses only those properties which the charter of its creation confers upon it, either expressly or as accidental to its very existence’ Chief Justice Marshall. In the words of professor Haney “A company is an incorporated association, which is an artificial person created by law, having a separate entity, with a perpetual succession and a common seal.” This definition sums up the meaning as well as the features of a company succinctly.

Features:

The distinctive features of the company help to understand the realms of a company. Following are the main features:

- a) ***Incorporated Association:*** Registration of a company is mandatory under the Companies Act. The minimum number required for the same is seven in

case of public company, two in case of a private company and one for one Person Company.

- b) ***Separate Legal Entity:*** On incorporation a company acquires a unique character of being a separate legal entity. It bears its own name and acts under the same and owns assets in its name. It has a separate existence from that of the subscribers to the memorandum and also from the personality of those who compose it. Members can enter into contract with company, acquire right against it or incur liability to it. For the debts of the company, only its creditors can sue it and not its members.

A company can own property, have bank account, raise loans, incur liabilities and enter into contracts. A company is capable of owning, enjoying and disposing of property in its own name. Although the capital and assets are contributed by the shareholders, the company becomes the owner of its capital and assets. The shareholders are not the private or joint owners of the company's property.

A member does not even have an insurable interest in the property of the company. The leading case on this point is of *Macaura v. Northern Assurance Co. Limited* (1925). Macaura (M) was the holder of nearly all (except one) shares of a timber company. He was also a major creditor of the company. M insured the company's timber in his own name. The timber was lost in a fire. M claimed insurance compensation. Held, the insurance company was not liable to him as no shareholder has any right to any item of property owned by the company, for he has no legal or equitable interest in them.

- c) ***Perpetual Succession:*** A company once incorporated can never be incapacitated till it is wound up on the grounds specified by the Act. Its members may come and go, but the company goes on forever. Even the death or insolvency or retirement of its members leaves the company unaffected. For example companies like TATA and Birla are in existence for over 100 years. This is possible only due to the fact that the company has perpetual existence.
- d) ***Limited Liability:*** Limited liability means that the member of the company, in case of liquidation or winding-up of the company, cannot be called upon to contribute more than that has been agreed. The liability of a member depends upon the kind of company of which he is a member. Thus, in the case of a limited liability company, the liability of the members of the company is limited to the extent of the nominal value of shares held by them. In the case of a company limited by guarantee, the members are liable only to the extent of the amount guaranteed by them and that too only when the company goes into liquidation. However, if it is an unlimited company, the liability of its members is unlimited as well.
- e) ***Artificial Person:*** A company is an artificial person created by law and is clothed with all the rights of an individual and being subject to duties. It is called an artificial person since it is invisible, intangible, existing only in the contemplation of law. As a legal person it can enter into contracts, possess properties in its own name, sue and can be sued by others. However, it is not a citizen under the Citizenship Act, 1955 or the Constitution of India. But, certain fundamental rights enshrined in the Constitution for protection of

“person”, e.g., right to equality (Article 14) are available to company and also, it has nationality, domicile and residence.

- f) **Common Seal:** A company being an artificial person functions through its Directors. Common seal is the official signature of a company, which is affixed by the officers and employees of the company on its every document. The Companies (Amendment) Act, 2015, has made the common seal optional by omitting the words “and a common seal” from Section 9 so as to provide an alternative mode of authorization for companies who opt not to have a common seal. This amendment provides that the documents which need to be authenticated by a common seal will be required to be so done, only if the company chooses to have a common seal. In case a company does not have a common seal, the authorization shall be made by two Directors or by a Director and the Company Secretary, wherever the company has appointed a Company Secretary.
- g) **Transferability of Shares:** Section 44 of the Companies Act, 2013, provides that the shares held by the members are movable property and can be transferred from one person to another in the manner provided by the Articles of Association. If the Articles are silent on the provision for the transfer of shares, the Regulations contained in Table “F” in Schedule I to the Companies Act, 2013, are applicable; and if Table “F” is expressly excluded, the transfer of shares will be governed by the general law relating to transfer of movable property. However, in Private Company, there are restrictions with respect to transferability of shares, but the right to transfer is not taken away absolutely. The objective behind the right of restriction on the transfer of shares is to preserve the composition of the shareholding.

Types of Companies

The Companies Act, 2013, has broadly classified the companies into various classes. Companies may be classified into various classes on the following basis:

i) **On the basis of liability:**

- a) **Company limited by shares:** is one in which the liability of the members is limited by its memorandum of association to the amount (if any) unpaid on the shares held by them [Section 2(22)].
- b) **Company limited by guarantee:** is one where the liability of its members is limited by the memorandum to such amount as the members may respectively undertake by the memorandum to contribute to the assets of the company in the event of its being wound up Section 2(21). These types of companies may or may not have a share capital. Such a company may be useful only where no working funds are needed or where these funds can be held from other sources like endowment, fees, charges, donations, etc.

In *Narendra Kumar Agarwal vs. Saroj Maloo*, the Supreme Court laid down that the right of a guarantee company to refuse to accept the transfer by a member of his interest in the company is on a different footing than that of a company limited by shares. Similarly, the membership of a guarantee company may carry privileges much different from those of ordinary shareholders.

- c) **Unlimited company:** is a company where the liability of its members is unlimited [Section 2(92)] and the liability of a member ceases when he ceases to be a member. The liability of each member extends to the whole amount of the company's debts and liabilities, but he will be entitled to claim contribution from other members. Till the time a company is a going concern the liability will be limited to the extent of shares. The creditors can institute proceedings for winding up of the company for their claims. The official liquidator may call the members for their contribution towards the liabilities and debts of the company, which can be unlimited.

ii) **On the basis of members:**

- a) **One Person Company (OPC):** The Companies Act, 2013, introduced a new class of companies which can be incorporated by a single person. The concept of OPC was recommended in 2005, by a committee headed by Dr JJ Irani. Section 2(62) of the Companies Act, 2013, defines one person company (OPC) as a company which has only one person as a member. OPC, unlike the sole proprietorship is a separate legal entity with a limited liability of the member.
- b) **Private Company [Section 2(68)]:** "Private company" means a company having a minimum paid-up share capital as may be prescribed, and which by its articles,—
- restricts the right to transfer its shares;
 - except in case of One Person Company, limits the number of its members to two hundred
 - prohibits any invitation to the public to subscribe for any securities of the company
- c) **Small Company:** Small company given under the section 2(85) of the Companies Act, 2013 which means a company, other than a public company—
- paid-up share capital of which does not exceed fifty lakh rupees or such higher amount as may be prescribed which shall not be more than ten crore rupees; and
 - turnover of which as per profit and loss account for the immediately preceding financial year does not exceed two crore rupees or such higher amount as may be prescribed which shall not be more than one hundred crore rupees.

The features of Small Company

- A private company
 - Paid up capital – not more than Rs. 50 lakhs or Turnover – not more than Rs. 2 crores.
 - Should not be – Section 8 company or a holding or a subsidiary company.
- d) **Public company [Section 2(71)]:** "Public company" means a company which

- is not a private company; and
- has a minimum paid-up share capital, as may be prescribed.

Status of private company, which is subsidiary to public company: In view of Section 2(71) of the Companies Act, 2013, a Private company, which is subsidiary of a public company, shall be deemed to be a public company for the purpose of this Act, even where such subsidiary company continues to be a private company in its articles.

According to section 3(1) (a), a company may be formed for any lawful purpose by seven or more persons, where the company to be formed is to be a public company.

iii) On the basis of control:

- a) **Holding and subsidiary companies:** ‘Holding and subsidiary’ companies are relative terms. A company is a holding company of another if the other is its subsidiary. According to section 2(87) a company shall be deemed to be a subsidiary of another if—
 - the other company controls the composition of the Board of Directors; or
 - exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies.
- b) **Associate company [Section 2(6)]:** means a company in which that other company has a significant influence i.e., control of at least twenty per cent of total voting power, or control of or participation in business decisions under an agreement; but which is not a subsidiary company of the company having such influence and includes a joint venture company. Example : A Ltd. is a Public Company and holds 23% of share capital in B Ltd. and 15% share capital of C Ltd. By virtue of the shareholding pattern, B Ltd. will be known as the Associate Company of A Ltd. (as the holding is more than 20%), whereas C Ltd. will not be Associate as the required 20% is not there and hence no significant influence.

iv) On the basis of Access to Capital:

- a) **Listed company:** A company which has any of its securities listed on any recognised stock exchange. [section 2(52)]
- b) **Unlisted company** means a company other than listed company.

v) Other companies:

- a) **Government company** [Section 2(45): is a Company in which not less than 51% of the paid-up share capital is held by-
 - the Central Government, or
 - by any State Government or Governments, or
 - partly by the Central Government and partly by one or more State Governments, and the section includes a company which is a subsidiary company of such a Government company.

- b) **Foreign Company [Section 2(42)]**: is any company or body corporate incorporated outside India which—
- has a place of business in India whether by itself or through an agent, physically or through electronic mode; and
 - conducts any business activity in India in any other manner
- c) **Section 8 company**: Company which is formed to—
- promote the charitable objects of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment, etc.
 - Such company intends to apply its profit (if any) in:
 - o promoting its objects and
 - o prohibiting the payment of any dividend to its members.

Examples of section 8 companies are FICCI, ASSOCHAM, National Sports Club of India, CII, etc.

These companies are licensed by Central government and the registrar, on application register such person or association of persons as a company under this section 8. On registration the company enjoys same privileges and obligations as a limited company.

The Central Government may revoke the licence of such a company if it contravenes any of the requirements or the conditions to which a licence is issued or where the affairs of the company are conducted fraudulently or violate the objectives of the company or are prejudicial to public interest. But before such revocation, the Central Government must give it a written notice of its intention to revoke the licence and opportunity to be heard in the matter. On revocation of the licence; in the public interest, the central government has power to amalgamate it with another company registered under this section having similar objects.

- d) **Dormant company (Section 455)**: where a company is formed and registered under this Act for a future project or to hold an asset or intellectual property and has no significant accounting transaction, such a company or an inactive company may make an application to the Registrar in such manner as may be prescribed for obtaining the status of a dormant company.
- e) **“Inactive company”** means a company which has not been carrying on any business or operation, or has not made any significant accounting transaction during the last two financial years, or has not filed financial statements and annual returns during the last two financial years.
- f) **Nidhi Companies**: also called the ‘Mutual benefit society’ means a company which the Central Government may, by notification in the Official Gazette, declare to be a Nidhi or Mutual Benefit Society, as the case may be. Its main objective is to lend and borrow money to the members, for the purpose of their mutual benefits and to cultivate savings habits among the members. These are classified as non-banking financial Company (NBFC).

g) Public Financial Institutions (PFI): By virtue of Section 2(72) of the Companies Act, 2013, the following institutions are to be regarded as public financial institutions:

- i) the Life Insurance Corporation of India, established under the Life Insurance Corporation Act, 1956;
- ii) the Infrastructure Development Finance Company Limited,
- iii) specified company referred to in the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002;
- iv) institutions notified by the Central Government under section 4A(2) of the Companies Act, 1956 so repealed under section 465 of this Act;
- v) such other institution as may be notified by the Central Government in consultation with the Reserve Bank of India:

An institution shall be so notified as PFI if —

- it has been established or constituted by or under any Central or State Act other than this Act or the previous Companies Law; or
- at least 51% of the paid-up share capital is held or controlled by the Central Government or by any State Government or partly by the Central Government and partly by one or more State Governments.

Formation and Incorporation of Companies

Section 3(1) states that a company may be formed for any lawful purpose by –

- a) seven or more persons, where the company to be formed is to be a public company;
- b) two or more persons, where the company to be formed is to be a private company; or
- c) one person, where the company to be formed is to be One Person Company.

A company formed under Section 3(1) may be either –

- a) a company limited by shares; or
- b) a company limited by guarantee; or
- c) an unlimited company.

Stages in the formation of a company

Formation of a company is a lengthy process involving completion of legal formalities and procedures. It involves following stages

- a) Promotion
- b) Registration or incorporation
- c) Commencement of business

a) Promotion

The 1st stage in the formation of a company is ‘promotion’. At this stage the idea to carry on the business is conceived by an individual or a group of persons called ‘Promoter’. Thus a persons who conceives the idea of forming

the company, floats the company, enters into preliminary contracts, agreements and purchase of property in his own name and hands it over to the company on its incorporation, is called a “Promoter”. A promoter may be an individual, firm, an association of persons or a body corporate. However, a person acting merely in a professional capacity e.g., the solicitor, banker, accountant, etc., are not regarded as promoters. Every company shall inter alia, while preparing the annual returns, give particulars of its promoter.

The Companies Act, 2013 defines the term “Promoter” under section 2(69) which means a person—

- who has been named as such in a prospectus or is identified by the company in the annual return; or
- who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; or
- in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act.

b) *Registration or incorporation*

Section 7(1) of the Act provides for the detailed procedure for **incorporation of company**.

Filing of the documents and information with the registrar of the company: Following documents and information is to be filed with the registrar within whose jurisdiction the registered office of the company is proposed to be situated-

- i) the Memorandum and Articles of the company duly signed by all the subscribers to the Memorandum.
- ii) a declaration by person who is engaged in the formation of the company (an advocate, a chartered accountant, cost accountant or company secretary in practice), and by a person named in the Articles (director, manager or secretary of the company), that all the requirements of this Act and the rules made in respect of registration and matters precedent or incidental thereto have been complied with;
- iii) a declaration from each of the subscribers to the Memorandum and from persons named as the First Directors, if any, in the Articles stating that-
 - a) he is not convicted of any offence in connection with the promotion, formation or management of any company, or
 - b) he has not been found guilty of any fraud or misfeasance or of any breach of duty to any company under this Act or any previous company law during the last five years, and that all the documents filed with the Registrar for registration of the company contain information that is correct and complete and true to the best of his knowledge and belief;
- iv) the address for correspondence till its registered office is established;
- v) the particulars (names, including surnames or family names, residential address, nationality) of every subscriber to the Memorandum along with proof of identity, and in the case of a subscriber being a body corporate, such particulars as may be prescribed.

- vi) the particulars (names, including surnames or family names, the Director Identification Number, residential address, nationality) of the persons mentioned in the articles as the first director of the company ; and
- vii) the particulars of the interests of the persons mentioned in the articles as the first directors of the company in other firms or bodies corporate along with their consent to act as directors of the company in such form and manner as may be prescribed.

Particulars provided in this provision shall be of the individual subscriber and not of the professional engaged in the incorporation of the company [The Companies (Incorporation) Rules, 2014].

Issue of certificate of incorporation on registration: once satisfied the Registrar, shall register all the documents and information in the register and issue a certificate of incorporation in the prescribed form to the effect that the proposed company is incorporated under this Act.

The Registrar shall allot to the company a corporate identity number on and from the date mentioned in certificate of incorporation and it will be included in the certificate.

c) *Commencement of Business [Section 10A]*

According to Section 10A, a company incorporated after the commencement of the Companies (Amendment) Ordinance, 2019, and having a share capital shall not commence any business or exercise any borrowing powers unless—

- a declaration is filed by a director within 180 days of the date of incorporation, in a prescribed form and verified, with the Registrar that every subscriber to the Memorandum has paid the value of the shares agreed to be taken by him on the date of making of such declaration; and
- The company has filed with the Registrar a verification of its registered office as provided in sub-section (2) of section 12.

In case of default, in complying with the requirements of this section, the company shall be liable to a penalty of fifty thousand rupees and every officer who is in default shall be liable to a penalty of one thousand rupees for each day during which such default continues but not exceeding an amount of one lakh rupees.

Further, the registrar has power to initiate action for the removal of the name of the company from the register of companies, if declaration is not filed in 180 days and the Registrar has reasonable cause to believe that the company is not carrying on any business or operations.

From the date of incorporation, the subscribers to the Memorandum and all other persons, who subsequently, become members of the company, shall be a body corporate by the name contained in the Memorandum, capable of exercising all the functions of an incorporated company under this Act and having perpetual succession (until it is dissolved by liquidation or struck out of the register). A company on registration acquires a separate existence and the law recognizes it as a legal person separate and distinct from its members, thereby have power to acquire, hold and dispose of property, both movable and immovable, tangible and intangible, to contract and to sue and be sued, by the said name. There will

also come into existence a binding contract between the company and its members as evidenced by the Memorandum and Articles of Association.

Activity 1

1) Is company a citizen?

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2) Why a company is called an artificial person?

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3) Does a company has nationality

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4) Choose the right answer:

- i) A company, in which the liability of its members is limited to unpaid amount on the shares.
 - a) Company limited by guarantee b) Company limited by shares
- ii) The minimum number of members required to register a public company is ____ (a) 2 (b) 7
- iii) When is a company said to have been registered?
 - a) When it gets the certificate of commencement of business.
 - b) When it gets the certificate of incorporation

5) State whether true or false

- a) The Companies Act, 2013 is applicable on Insurance companies.
- b) Is it compulsory for every company to have a common seal?

4.3 PRINCIPAL DOCUMENTS OF A COMPANY

There are three fundamental documents of a company. They are:

- a) **Memorandum of Association** is the charter of a company which lays down the objects of the company and also all the specific functions, operations and limitations.
- b) **Articles of Association** is the document that constitutes all the rules and regulations for the conduct of the internal management of the company.
- c) **Prospectus**

4.3.1 Memorandum of Association (MoA)

Memorandum means the memorandum of association of a company as originally framed or as altered from time to time in pursuance of any previous company law or of this Act [section 2(56)]. It is the document that regulates the company's external affairs, and complements the Articles of Association. It is the most important document and commonly referred as the constitution or the charter of the company. It is the very foundation on which the whole edifice of the company is built. It defines the constitution and the scope of the powers of the company with which it has been established under the Act.

A company has to stick to the provisions laid in the Memorandum, no matter how crucial may be the necessity for the departure. It cannot enter into a contract or engage in any trade or business, which is beyond the power conferred on it by the Memorandum. If it does so, it would be ultra vires the company and void.

The Memorandum of a company shall be in respective forms specified in Tables A, B, C, D and E in Schedule I [Section 4].

Table A- for company limited by shares.

Table B - for a company limited by guarantee and not having a share capital.

Table C -for company limited by guarantee and having a share capital.

Table D - for association of an unlimited company.

Table E - for an unlimited company and having share capital.

The Memorandum and Articles of a company must be as closed to model forms, as possible, depending upon the circumstances.

Contents of Memorandum

The memorandum of a company shall state—

- a) **Name Clause:** Name clause consists the name of the company with the last word “Limited” in the case of a public limited company and “Private Limited” in the case of a private limited company. This clause is not applicable on the companies formed under section 8 of the Act. As per MCA notification dated 5th June, 2015, a Government company's name must end with the word “Limited”. In the case of One Person Company, the words “One Person Company” should be included below its name.

If a company changes its activities which are not reflected in its name, it shall change its name in line with its activities within six months from the change of activities after complying with all the provisions as applicable to change of name.

- b) **Domicile/Registered Office clause:** Name of the State in which the registered office of the company is to be situated. A company shall, on and from the fifteenth day of its incorporation and at all times thereafter, have a registered office capable of receiving and acknowledging all communications and notices as may be addressed to it.

- c) **Object clause** : it states:
- i) the main objects which the company wishes to pursue at the time of incorporation; and
 - ii) objects incidental to the attainment of the main object; and
 - iii) other objects.
- d) **Liability clause** : the liability of members of the company, whether limited or unlimited, and also state:
- in the case of a company limited by shares, that the liability of its members is limited to the amount unpaid, if any, on the shares held by them; and
 - in the case of a company limited by guarantee, the amount up to which each member undertakes to contribute:
 - to the assets of the company in the event of its being wound-up while he is a member or within one year after he ceases to be a member, for payment of the debts and liabilities of the company or of such debts and liabilities as may have been contracted before he ceases to be a member, as the case may be; and
 - to the costs, charges and expenses of winding-up and for adjustment of the rights of the contributories among themselves;
- e) **Capital Clause**: In case of company the amount of the share capital with which the company is to be registered i.e., authorized capital, the number and face value of shares into which the capital of the company is divided and the number of shares, the subscribers to the Memorandum have agreed to take, indicated opposite their names, which shall not be less than one share. A company not having share capital need not have this clause.
- f) **Association clause**: The Memorandum concludes with the association clause. It contains declaration from several persons whose names are subscribed are desirous of forming a company and agree to take shares mentioned against the name of each person. Every subscriber to the Memorandum shall take at least one share, and shall write against his name, the number of shares taken by him.

The above clauses are called compulsory clauses, or “Conditions”. In addition to these a memorandum may contain other provisions, for example rights attached to various classes of shares.

In the case of OPC, the name of the person who, in the event of death of the subscriber, shall become the member of the company.

The memorandum must be printed, divided into paragraphs, numbered consecutively, and signed by at least seven persons (two in the case of a private company and one in the case of One Person Company) in the presence of at least one witness, who will attest the signatures. The particulars about the signatories to the memorandum as well as the witness, as to their address, description, occupation, etc., must also be entered.

The Memorandum of Association of a company cannot contain anything contrary to the provisions of the Companies Act. If it does, the same shall be devoid of any legal effect. Similarly, all other documents of the company must comply with the provisions of the Memorandum.

The Memorandum of Association (MOA) can be altered anytime but there are certain conditions which have to be complied before alteration [section 13].

4.3.2 Articles of Association (AoA)

Articles means the Articles of Association of a company as originally framed or as altered from time to time or applied in pursuance of any previous company law or of this Act[section2(5)]. It is a document supplementary to the Memorandum of Association, which deals exclusively with the rules and regulations of the internal management of the company. These articles or rules are commonly known as the by laws of the company. These express a contract between the company and its members and among the members themselves. These are subordinate to the Memorandum and, hence, not in anyway contradict it. Schedule I of the Act gives four formats in Table F,G,H,I and J which may be used to frame the Articles of Association. A company may adopt all or any of the regulations contained in the model articles applicable to such company.

Contents:

Section 5 of the Companies Act, 2013, seeks to provide the contents and model of articles of association. The section lays the following law-

- 1) The regulations for management of the company.
- 2) Such matters, as are prescribed under the rules. However, a company may also include such additional matters as may be considered necessary for its management.
- 3) Provisions for entrenchment: Usually an article of association may be altered by passing special resolution but entrenchment makes it more difficult to change it. Entrenchment means making something more protective. The articles may contain provisions for entrenchment to the effect that specified provisions of the articles may be altered only if conditions or procedures as that are more restrictive than those applicable in the case of a special resolution, are met or complied with. The provisions for entrenchment shall only be made either on formation of a company, or by an amendment in the articles agreed to by all the members of the company in the case of a private company and by a special resolution in the case of a public company. The company shall give notice to the Registrar of such provisions in such form and manner as may be prescribed.

Section 14 of the Companies Act, 2013, vests companies with power to alter or add to its articles. A company cannot divest itself of these powers [Andrews vs. Gas Meter Co. [1897] 1 Ch. 161]. Matters as to which the memorandum is silent can be dealt with by the alteration of article.

4.3.3 Prospectus

Companies raise their enormous capital needs from banks, international financial institutions, defined group or inner circle (called 'Private Placement of securities')

,as well as from general public (called 'Public Offer'). These creditors lend only if the company is creditworthy. In order to assure its creditors that it is creditworthy and has business acumen to develop, manage, and earn profits for its shareholders, it offers the details of its competence in a document called 'prospectus'. It is after studying this document, the creditor makes his decision to accept it. Thus a contract between a public company and its creditors comes into existence.

According to the definition u/s 2(70) prospectus mean any document described or issued as a prospectus and includes a red herring prospectus referred to in section 32 or shelf prospectus referred to in section 31 or any notice, circular, advertisement or other document inviting offers from the public for the subscription or purchase of any securities of a body corporate.

The definition includes any notice, circular, advertisement or any other document inviting offers from public for the subscription or purchase of securities.

Legal Requirements

Prospectus to be dated and signed and to state information set out such reports on financial information as may be specified by the Securities and Exchange Board of India in consultation with the Central Government.

Prospectus can be issued only after delivery to Registrar for filing.

Prospectus shall not be valid if it is issued after days from the date on which a copy thereof is delivered to the Registrar of Companies (ROC).

Types of Prospectus:

- i) **Red Herring Prospectus:** Red herring Prospectus means a prospectus which does not include complete particulars of the quantum or price of the securities included therein. In simple terms a red herring prospectus contains most of the information pertaining to the company's operations and prospects, but does not include key details of the issue such as its price and the number of shares offered.

According to section 32 a company proposing to make an offer of securities may issue a red herring prospectus prior to the issue of a prospectus. It should be filed with the Registrar at least three days prior to the opening of the subscription list and the offer.

A red herring prospectus has the same obligations as the prospectus and any variation between the two shall be highlighted as variations in the prospectus.

Upon the closing of the offer of securities under this section, the prospectus stating- the total capital raised, the closing price of the securities and any other details not included in the red herring prospectus shall be filed with the Registrar and the Securities and Exchange Board of India (SEBI).

- ii) **Shelf Prospectus & Information Memorandum:** 'Shelf Prospectus' is a prospectus in respect of which the securities or class of securities included therein are issued for subscription in one or more issues over a certain period without the issue of a further prospectus. In other words a Shelf Prospectus is a single prospectus for multiple public issues. Issuer is permitted to offer and sell securities to the public without a separate prospectus for each act of

offering for a certain period. It is a prospectus issued by financial institution or banks.

As already discussed it is mandatory for public company which issues securities to public, to issue prospectus. This is a cumbersome process. In order to save time and simplify the process a leeway is given under law in the form of shelf prospectus. Such companies can issue one time prospectus which will be valid for maximum one year. During this duration when every the company thinks of issuing securities as per that prospectus – it doesn't have to go through the whole process of issue of fresh prospectus.

Under the Act, SEBI may provide by regulations in this behalf any class or classes of companies to file a shelf prospectus with ROC.

Such prospectus is to be submitted at the stage of the first offer of securities, indicating a period not exceeding one year as the period of validity of such prospectus. The validity period shall commence from the date of opening of the first offer of securities under that prospectus and in respect of a second or subsequent offer of such securities issued during the period of validity of that prospectus, no further prospectus is required.

An **information memorandum** is required to be filed by a company filing a shelf prospectus which shall contain all material facts relating to

- new charges created,
- changes in the financial position of the company as have occurred between the first offer of securities or the previous offer of securities and the succeeding offer of securities and
- such other changes as may be prescribed, with the Registrar within the prescribed time, prior to the issue of a second or subsequent offer of securities under the shelf prospectus.

The information memorandum shall be prepared in Form PAS-2 and filed with the Registrar along with the prescribed fee within one month prior to the issue of a second or subsequent offer of securities under the shelf prospectus.

- iii) ***Abridged Prospectus***: A prospectus is a very voluminous document, and one cannot be expected to read it completely. An abridged prospectus is a summary of the prospectus containing such details as prescribed by the SEBI. According to section 2(1) of the Act “abridged prospectus” means a memorandum containing such salient features of a prospectus as may be specified by the SEBI by making regulations in this behalf.

Section 33 makes it compulsory that every application form for the purchase of any of the securities shall be accompanied by an abridged prospectus. And a copy of the prospectus shall, on a request being made by any person before the closing of the subscription list and the offer, be furnished to him.

- iv) ***Deemed Prospectus (Offer for Sale)***: The document “Offer for sale” is an invitation to the general public to purchase the shares of a company through an intermediary, such as an issuing house or a merchant bank. A company may allot or agree to allot any shares or debentures to an “Issue house” without there being any intention on the part of the company to make shares

or debentures available directly to the public through issue of prospectus. The issue house in turn makes an “Offer for sale” to the public.

Any document by which the offer for sale to the public is made shall, for all purposes, be deemed to be a prospectus issued by the company.

Securities will be considered to be offered for sale to the public if it is shown:

- a) that an offer of the securities or of any of them for sale to the public was made within 6 months after the allotment or agreement to allot; or
- b) that at the date when the offer was made, the whole consideration to be received by the company in respect of the securities had not been received by it.

Information Memorandum together with the Shelf Prospectus is deemed Prospectus

Matters to be stated in the Prospectus:

A prospectus is any document through which a company communicates and invites the public to invest into it and subscribe or purchase its securities. A prospectus contains information about the financial position of the company, its directors, signatories to the memorandum, the objects of public offer, additional charges created, changes in the finance etc. It is mandatory for a company to provide correct information in the prospectus or it would be liable for misrepresentation and fraud.

Section 26 (1) lays down the matters required to be disclosed and included in a prospectus and requires the filing of the prospectus with the Registrar before it is issued.

The matters which are to be stated in a prospectus are as under:

- i) names and addresses of the registered office of the company, company secretary, Chief Financial Officer, auditors, legal advisers, bankers, trustees, if any, underwriters and such other persons as may be prescribed;
- ii) dates of the opening and closing of the issue, and declaration about the issue of allotment letters and refunds within the prescribed time;
- iii) a statement by the Board of Directors about the separate bank account where all monies received out of the issue are to be transferred and disclosure of details of all monies including utilised and unutilised monies out of the previous issue in the prescribed manner;
- iv) details about underwriting of the issue;
- v) consent of the directors, auditors, bankers to the issue, expert's opinion, if any, and of such other persons, as may be prescribed;
- vi) the authority for the issue and the details of the resolution passed therefor;
- vii) procedure and time schedule for allotment and issue of securities;
- viii) capital structure of the company in the prescribed manner;
- ix) main objects of public offer, terms of the present issue and such other particulars as may be prescribed;
- x) main objects and present business of the company and its location, schedule of implementation of the project;

- xi) particulars relating to— (A) management perception of risk factors specific to the project; (B) gestation period of the project; (C) extent of progress made in the project; (D) deadlines for completion of the project; and (E) any litigation or legal action pending or taken by a Government Department or a statutory body during the last five years immediately preceding the year of the issue of prospectus against the promoter of the company;
- xii) minimum subscription, amount payable by way of premium, issue of shares otherwise than on cash;
- xiii) details of directors including their appointments and remuneration, and such particulars of the nature and extent of their interests in the company as may be prescribed; and
- xiv) disclosures in such manner as may be prescribed about sources of promoter's contribution;

If a prospectus is issued in contravention of the provisions of section 26, the company shall be punishable with fine which shall not be less than 50,000 rupees but which may extend to 3 lakh rupees and every person who is knowingly a party to the issue of such prospectus shall be punishable with imprisonment for a term which may extend to 3 years or with fine which shall not be less than 50,000 rupees but which may extend to 3 lakhs rupees, or with both.

The company has to use the funds strictly in accordance with the prospectus. Any deviations require pre-approval of the investors and 'recall option' needs to be given to the dissenting investors. Deviation regarding use of proceeds of issue for buying, trading or otherwise dealing in equity shares of any other listed company is not permitted [section 27].

Misstatements in Prospectus and Consequences:

Misstatement means stating something that is false or inaccurate. It can either be due to commission or omission or both. Anything in the prospectus that deceives and misleads an investor and induces him to buy shares or debentures calls for remedies both against the company and its promoters, directors and every person involved. Misstatement in prospectus is a serious offence and attracts civil liability against company and criminal liability or civil liability or both on every person who authorises the issue of such prospectus.

Activity 2

1) What is a shelf Prospectus?

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2) _____ is known as a charter of a Company.

3) The rules and regulations for the internal management of a company are contained in its _____

4) _____ documents may be changed with retrospective effect?

4.4 SHARE AND LOAN CAPITAL

A public company raises the necessary funds by issuing shares, debentures, and by accepting public deposits. These are discussed in detail in the following paras:

4.4.1 Share Capital

Share Capital is the capital raised by the company by issue of shares. It is the corpus or fund to be used for the object of the company to generate profits. The memorandum of company provides for share capital clause. Companies limited by guarantee or unlimited companies need not have share capital. Various terms used with reference to capital can be understood as:

- 1) **Nominal or Authorised or Registered Capital:** Represents the maximum share capital which the company is authorized to issue by its memorandum and upon which it pays the stamp duty. This form of capital has been defined in section 2(8).
- 2) **Issued capital:** It denotes the nominal value of that part of authorized share capital which is issued or offered to the general public from time to time for subscription and includes the shares allotted for consideration other than cash. This form of capital has been defined in section 2(50).
- 3) **Subscribed capital:** It is that part of the issued share capital, which the general public for the time being has subscribed or application has been received from the public. This form of capital has been defined in Section 2(86).
- 4) **Called-up capital:** It denotes that part of allotted (Subscribed) share capital, which has been called up by the company, from the subscribers to pay. Section 2(15).
- 5) **Paid up Capital:** It is the total amount paid or credited as paid up on shares issued. It is equal to called up capital less calls in arrears.
- 6) **Uncalled capital:** it is the remainder of the issued capital which is not been called ; it may be called any time but is subject to the term of issue of shares and provision in article of association.
- 7) **Reserve Share Capital:** A limited company, by a special resolution, may declare that a portion or whole of its uncalled share capital shall not be called except in the event of company's winding up and this portion of uncalled share capital is called reserve capital.

Types of Shares:

The capital of the company is divided into invisible units of a fixed amount. Each of such unit is called a 'share'. Share, means a share in the share capital of a company and includes stock except where a distinction between stock and share is expressed or implied. Evidenced by share certificate [Section 2(84)]. It is a measure of the interest in the company's assets to which a person holding a share is entitled. The rights and obligations attaching to a share are those prescribed by the Memorandum and the Articles of a company. A shareholder not only has contractual rights against the company, but also certain other rights which accrue to him according to the provisions of the Companies Act.

Stock can be defined as the “aggregate of fully paid-up shares” consolidated and divided for the convenience of holding into different parts. Its advantage is that unlike the share which is indivisible, it may split into a fraction of any amount, without regard to the original face value of share. Stock can be validly issued only when shares are fully paid-up.

According to the provisions u/s 43, the share capital of a company limited by shares; shall be of two kinds, namely:—

1) *Equity share capital*

- with voting rights; or
- with differential rights as to dividend, voting or otherwise in accordance with prescribed rules;

All share capital which is not preference share capital means equity share capital;

2) *Preference share capital* is that part of the issued share capital of the company limited by shares which carries or would carry a preferential right with respect to—

- a) payment of dividend; and
- b) repayment of capital, in the case of a winding up

Issue of Shares

A company can issue its shares either at par, at a premium or even at a discount

- i) ***Issue of shares at par:*** Shares are issued at par when subscribers are required to pay only the amount equivalent to the nominal or face value of the shares issued. ‘Par value’ is the notional face value of the shares which a company issues to its investors.
- ii) ***Issue of shares at premium:*** If the buyer is required to pay more than the face value of the share, then the share is said to be issued at a premium. The premium cannot be treated as profit and, therefore, cannot be distributed as dividend. The amount of premium received in cash and the equivalent of it received in kind must be kept in a separate bank account known as the ‘Securities Premium Account’.
- iii) ***Issue of shares at discount:*** If the buyer of shares is required to pay less than the face value of the share, then the share is said to be issued or sold at a discount. Share can be issued at discount if it is authorized by a resolution, that is,
 - The issue is of class of shares already issued
 - The maximum rate of discount must not exceed 10 per cent.
 - Not less than one year has, at the date of issue, elapsed since the date on which the company was entitled to commence business.
 - Issued within two months of the sanction by the Company Law Board.
 - Every prospectus must mention particulars of the discount allowed on the issue of shares.

- iv) **Issue of sweat Equity shares** : ‘Sweat-equity shares’ means equity shares issued by the company to employees or directors at a discount or for consideration other than cash . ‘Sweat equity shares’ may be issued for providing know-how or making available intellectual property rights (say, patents) or value additions.
- v) **Rights Issue [62(1)(a)]**: The existing members of the company have a right to be offered shares, when the company wants to increase its subscribed capital. Such shares are known as “right shares”. Or when a company (whether Private Limited Company, a Public Limited Company, listed or unlisted company) offers it shares to the existing shareholders in proportion to their existing share holding in the company for the purpose of raising fresh capital for the company. In other words it is a ‘pre-emptive right’ that an existing shareholder has in a company in preference to the outsider. It is a non- dilutive pro rata way to raise capital. It is not mandatory to buy the rights offered. A shareholder can either:
- 1) Ignore their rights and let it lapse.
 - 2) Transfer or sell the rights to other interested investors.

With these rights the shareholders of the company can purchase new shares at a discounted rate to the market price.

Legal requirements:

- 1) the offer shall be made by notice specifying the number of shares offered and limiting a time not being less than fifteen days and not exceeding thirty days from the date of the offer within which the offer, if not accepted, shall be deemed to have been declined;
 - 2) unless the articles of the company otherwise provide, the offer aforesaid shall be deemed to include a right exercisable by the person concerned to renounce the shares offered to him or any of them in favour of any other person; and the notice referred to in clause (i) shall contain a statement of this right;
 - 3) after the expiry of the time specified in the notice aforesaid, or on receipt of earlier intimation from the person to whom such notice is given that he declines to accept the shares offered, the Board of Directors may dispose of them in such manner which is not disadvantageous to the shareholders and the company.
- vi) **Bonus Issue**: Bonus Shares refers to a further issue of shares made by a company having share capital to its existing shareholders without any additional cost, in proportion to their existing holdings. Bonus shares are fully paid-up shares, issued to its members, out of-
- Its free reserves;
 - The securities premium account; or
 - The capital redemption reserve account.

No issue of bonus shares shall be made by capitalizing reserves created by the revaluation of assets.

Legal requirements:

The bonus shares can be issued only when:

- 1) it is authorized by its articles; If not, then amend the AOA
- 2) Recommended by the Board and authorized in the general meeting of the company;
- 3 The Company has not defaulted in
 - payment of interest or principal in respect of fixed deposits or debt securities issued by it;
 - payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus;
- 4) The partly paid-up shares, if any outstanding on the date of allotment, are made fully paid-up;
- 5) The company which has once announced the decision of its Board recommending a bonus issue shall not subsequently withdraw the same.
- 6) The authorized Capital should be sufficient to issue Bonus Shares, If not it should be increased first.
- 7) Bonus issue must be made out of free reserves built out of the genuine profits or securities premium or capital redemption reserve account.
- 8) Reserves created by revaluation of assets should not be used for issue of Bonus Shares.
- 9) Bonus issue should not be made in lieu of dividend.
- 10) Other such conditions as may be prescribed.

Transfer and Transmission

Transfer: it refers to the transfer of title to shares, voluntarily, by one party to another for adequate consideration under contract. Transfer deed is executed in transfer of share and stamp duty is payable on the market value of shares. Liabilities of transferor cease on the completion of transfer.

Transmission: it refers to the transfer of title to shares by the operation of law (i.e., death, insolvency or lunacy). It is initiated by legal heir or receiver. On death of a shareholder, his shares are transmitted to his legal representative. When a shareholder becomes insolvent, his shares are transmitted to his Official Receiver. And on shareholder becoming lunatic, his shares are transmitted to his administrator appointed by the Court.

Provisions relating to transfer and transmission are stated in section 56.

Buyback of Shares

A company whether public or private is empowered to purchase its own shares or other securities in certain cases out of following sources : a) Its free reserves; or b) The securities premium account; or c)The proceeds of any shares or other specified securities. However, buy-back of any kind of shares or securities shall not be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

Conditions for Buyback:

- 1) The buy-back must be authorized by the article and
- 2) approved by Board of Directors at a board meeting and/or by a special resolution (SR) passed by shareholders in general meeting, depending on the quantum of buy back:
 - Approval of Board of Directors- upto 10% of the total paid-up equity capital and free reserves of the company.
 - Approval of Shareholders- upto 25% of the aggregate of paid-up capital and free reserves of the company.
- 3) Shares to be bought back must be fully paid up
- 4) The Buy-back of shares of private & unlisted public companies may be:
 - from the existing shareholders on a proportionate basis;
 - by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.
- 5) Before the buy-back of shares, the company shall file with the Registrar of Companies a Letter of Offer.
- 6) The offer for buy back shall remain open for a minimum period of 15 days but not more than 30 days from the date of dispatch of letter of offer.
- 7) Buy-back shall be completed within a period of 1 (one) year from the date of passing of Special Resolution or Board Resolution, as the case may be.
- 8) The ratio of the aggregate of secured and unsecured debts owed by the company after buy-back shall not be more than twice the paid-up capital and its free reserves.

Surrender and forfeiture of shares

Surrender of shares implies giving the shares back to the company either by way of settlement of a dispute or for any other reason. The Companies Act contains no provision for surrender of shares. Thus, surrender of shares is valid only when Articles of Association provide for the same and; (a) Where forfeiture of such shares is justified; or (b) When shares are surrendered in exchange for new shares of same nominal value.

Forfeiture of shares: if a shareholder fails the call on share, the company has following option: (a) to sue him for amount due; and (b) forfeit the shares (i.e., take away the shares forcefully). A company may if expressly authorizes by its articles, forfeit shares for non-payment of calls and the same will not require confirmation of the Tribunal. Where power is given in the articles, it must be exercised strictly in accordance with the regulations regarding notice, procedure and manner stated therein, otherwise the forfeiture will be void. The power of forfeiture must be exercised bona fide and in the interest of the company. When the shares have been forfeited, the defaulting shareholder ceases to be member of the company and he loses all rights or interests in his shares.

Surrender is effected with the assent of the shareholder, whereas forfeiture is a proceeding in invitum (i.e., against a reluctant shareholder). But a surrender of shares not fully paid can only be accepted where forfeiture would be justified.

4.4.2 Debentures

The debenture is the most common form of raising loan from the public by a company. Under section 2(30), debenture includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not

When debentures are issued, the applicants are given certificates, under its common seal, if any, or under the signatures of two directors or a director and the company secretary, if he has been appointed, representing the money they have lent to the company.

Main characteristics of debenture are as follows:

- A debenture is in the form of a certificate.
- A debenture certificate must be delivered within six months from the date of allotment of debentures, unless the company is prohibited by any provision of law or any order of Court, Tribunal or any other authority.
- The company pays periodic interest, on the amount raised by issuing debentures till they are fully redeemed.
- Generally debentures carry a charge (fixed or floating) on the companies assets. However, debentures may be issued without charge.
- Like shares, debenture too is a movable property which is transferable as per the provisions contained in the Articles.
- Debentures, may be redeemed at the end of full term or in installments, say yearly or bi-yearly or any other period like in two installments.
- Debenture holders have no right to vote at any meeting.

4.4.3 Deposits

Apart from shares and debentures, Public Deposits are yet another important source of raising fund by a company. According to the Section 2(31) of the Act read with Rule 2(1)(c) of Companies (Acceptance of Deposits) Rules, 2014, 'deposit' includes any receipt of money by way of deposit or loan or in any other form by a company.

There are various receipts by the company that neither are nor include in deposits. Following are few of them:

- Receipts from the Central Government or a State Government or a local authority, or any amount received from any other source whose repayment is guaranteed by central, state or local government or any amount received from a statutory authority constituted under an Act of Parliament or a State Legislature.
- Receipts from foreign Governments, foreign/international banks, multilateral financial institutions etc.,
- Receipts as a loan from any banking company or from State Bank of India or its subsidiaries or from a co-operative bank.
- any amount received as a loan or financial assistance from Public Financial Institutions notified by the Central Government or any regional financial institutions, Insurance Companies or Scheduled Banks

- any amount received by a company from any other company;
- any amount received by way of subscription in respect of a chit under the Chit Fund Act, 1982
- any amount brought in by the promoters of the company by way of unsecured loan in pursuance of the stipulation of any lending financial institution or a bank
- any amount received in the course of or for the purposes of the business of the company

Activity 3

1) What is a preference share?

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2) What is buyback ?

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3) What is transfer and transmission of share?

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4) In absence of provision in article regarding transferability of shares and expressly exclusion of Table F, the transfer of shares will be governed by _____

5) _____ is a movable property and hence _____ in the manner provided by the articles of the company

4.5 COMPANY MANAGEMENT

Since a company is an artificial person its affairs are to be managed by natural persons. The management of corporation is a collective responsibility and those who manage the corporation are known by various names such as Director, Managing Directors, Secretaries, etc. The Board of Directors is a group of people elected by a company's shareholders to represent their interests. The Board acts as a governing body for a company or corporation. The Board of Directors in carrying out the day-to-day affairs of the company has to perform the role within the powers which are granted to them. Certain powers can be exercised by the

Board on their own and some with the consent of the company at the general meeting. The shareholders as owners of the company ratify the actions of the Board at the general meetings of the company. The meetings of the shareholders serve as the focal point for the shareholders to converge and give their decisions on the actions taken by the directors.

Board Constitution and its Powers:

The Board of Directors (BoD) is selected according to the procedure prescribed in the Companies Act, 2013, and the Articles of Association of the Company. All public companies are required to have a Board of Directors that includes members from inside and outside the organization.

Section 2(10) of the Companies Act, 2013, defines that “Board of Directors” or “Board”, as a collective body of the Directors of the company. Thus, the term ‘Board of Directors’ means a body duly constituted to direct, control and supervise the affairs of the company.

The BoD is the trustee of the company. They are responsible to act in the best interests of the Company and oversees that the management serves and protects the long term interests of all the stakeholders of the Company. They do this by meeting regularly to create policies for overall company oversight and management. The minutes of Board meeting and general meeting; and the reports of various committees are recorded and documented as the acts of the company.

Composition of Board

The BoD of every company shall consist of individuals only [Section 149]. Thus, no body corporate, association or firm shall be appointed as a Director in a company.

Section 149 of the Act, states that every company’s Board must have minimum 3 Directors in case of a public company, 2 Directors in the case of a private company, and 1 Director in the case of a One Person Company. A Company can appoint maximum 15 Directors but this can be increased after passing a special resolution in its General Meeting. Section 8 companies can have more than 15 Directors even without passing a special resolution.

Every company to have:

- a) At least one resident Director who must have stayed in India for a total period of not less than 182 days during the financial year.
- b) One women director.
- c) At least 1/3 of the total number of Directors as independent directors (fraction is to be rounded off to one).

Regulation 17 of SEBI (LODR) Regulations, 2018, further elaborates the composition of Board of Directors of the listed entity.

Power of Board [Section 179]

Section 179 deals with the powers of the Board. The Board cannot act on things for which powers are specifically vested with the members and are to be exercised during the general meeting. The powers of the BoD are exercised only by means of resolutions passed at meetings of the Board, namely :-

- a) to make calls on shares for unpaid money; to authorise buy-back of securities; to issue securities, including debentures, in or outside India
- b) to borrow monies;
- c) to invest the funds of the company;
- d) to grant loans or give guarantee or provide security in respect of loans;
- e) to approve financial statement and the Board's report;
- f) to diversify the business of the company
- g) to approve amalgamation, merger or reconstruction; or takeover of a company or acquire a controlling or substantial stake in another company
- h) to make political contributions or to Charitable trust (with prior permission at General Meeting if the aggregate amount, in any financial year, exceeds five percent of its average net profits for the three immediately preceding financial years
- i) to appoint or remove key managerial personnel (KMP);
- j) to appoint internal auditors and secretarial auditor
- k) to invite or accept or renew public deposits and related matters.

Restriction on Powers of Board [Section 180]

The following powers (with exemption to Private Companies) can be exercised by board only with the consent of the company by passing a special resolution, namely –

- a) to sell, lease or dispose of the whole or substantially the whole of the undertaking of the company
- b) to invest the amount of compensation received as a result of any merger or amalgamation; otherwise than in trust securities;
- c) to borrow money that exceed aggregate of its paid-up share capital, free reserves and securities premium ,
- d) to remit, or give time for the repayment of, any debt due from a Director

Directors:

The persons who are in charge of the management of the affairs of a company are termed as Directors. They are collectively known as Board of Directors or the Board.

There is no exhaustive definition of the term “Director” in the Act. Section 2(34) of the Act prescribed that “Director” means a Director appointed to the Board of a company. Only a natural person can be a Director.

Directors are both, agents and trustees in relation to a company. As agents of the Company they bind the company in various transactions that they enter on behalf of the company and as Trustees of the Company, the Directors are in a fiduciary relation, the Directors have to take care of properties, money, trade secrets, belongings, etc., of the company.

The maximum number of directorships, including any alternate directorship, a person can hold, is 20. However, the number of directorships in public companies/

private companies that are either holding or subsidiary company of a public company shall be limited to 10.[Section165].

A person shall not be eligible for appointment as a Director of a company, if –

- a) He is of unsound mind
- b) Undercharged insolvent;
- c) Pending application to be adjudicated as insolvent
- d) Convicted for moral turpitude, foreign exchange regulation, bears imprisonment for not less than six months and five years are yet to elapse from the date of expiry of the sentence. If a person is convicted of any offence and sentenced in respect thereof to imprisonment of seven years or more, he shall not be eligible to be appointed as a director in any company.
- e) A court or Tribunal has passed an order disqualifying him for appointment as a director and the order is in force;
- f) Shares held by him are in arrears for more than six months.
- g) Accepts directorships exceeding the maximum number of directorships
- h) If the court refrains for committing fraud, such as when the director of a public company, not filed financial statements or annual returns for any continuous period of three financial years, failed to repay the deposits or pay interest thereon or to redeem any debentures on the due date or pay interest due thereon or pay any dividend declared and such failure to pay or redeem continues for one year or more, and the five years have not elapsed.

Directors and their appointment

A Director to the Board may be appointed as:

Appointment of First Director Section 152(1): article of the company may provide for appointment of the first director. If no provision is made in the articles; the subscribers to the memorandum who are individuals shall be deemed to be the first directors of the company until the directors are duly appointed and in case of a One Person Company an individual being member shall be deemed to be its first director until the director or directors are duly appointed by the member in accordance with the provisions of this section.

Appointment of Subsequent Directors Section 152(2): Save as otherwise expressly provided in this Act, Every Subsequent Directors shall be appointed by the company in general meeting.

No person shall be appointed as a director of a company unless he has been allotted the Director Identification Number under section 154.

A person appointed as a Director shall not act as a Director unless he gives his consent to hold the office as Director and such consent has been filed with the Registrar within thirty days of his appointment in such manner as may be prescribed.

Women Director: Following class of companies should appoint at least one woman director

- a) Every listed company
- b) And every other public company with paid up capital of Rs.100 crores or more or with turnover of Rs. 300 crores or more must have at least one Women Director

Every existing company was required to appoint a woman Director within one year from the commencement of the Act and every newly incorporated company shall appoint a women director within six months.

Independent Director: An independent director means a director other than a Managing Director or a whole-time Director or a nominee Director who does not have any material or pecuniary relationship with the company/ directors.

Following companies to have specified number of independent directors.

All the listed public company would have at least 1/3 of the total number of Directors as Independent Directors (fraction is to be rounded off to one).

Other public companies, with paid up capital of Rs.10 crore or more, or with turnover of Rs.100 crore or more, or with outstanding loans, debentures and deposits of Rs.50 crore or more to have at least 2 Independent Directors.

An independent director can be appointed for a term of up to five consecutive years on the Board. However, in case of his reappointment for further five year then special resolution is to be passed in general meeting and disclosure of such appointment is made in the Board's report.

Alternate Director: Whether in public or private company, the Board can appoint Alternate Director, provided it is authorized by its articles or by a resolution passed by the company in general meeting. The person to be appointed as alternate director should not be director in the same company or acting as a an alternate director for any other Director in the company

Alternate Director can be appointed only if a director is absent for a period of not less than 3 months from India.

In case an alternate director is to be appointed as an Independent Director, it must be ensured that the proposed appointee also satisfies the criteria of Independence.

An alternate Director cannot hold the office longer than the term of the Director in whose place he has been appointed. Further, he will have to vacate the office, if and when the original Director returns to India.

Additional Director: The Articles of a company may confer on its Board of Directors the power to appoint any person, other than a person who fails to get appointed as a director in a general meeting, as an additional director at any time. s/he shall hold office up to the date of the next annual general meeting or the last date on which the annual general meeting should have been held, whichever is earlier.

Small Shareholder Director: Every listed company on its own or upon a notice from a) not less than one thousand small shareholders; or (b) one-tenth of the total number of such shareholder may have one director elected by such small

shareholders, whichever is lower; have a small shareholders' director elected by the small shareholder and appointed.

“Small shareholder” means a shareholder holding shares of nominal value of not more than twenty thousand rupees or such other sum as may be prescribed

Nominee Director: Subject to the articles of a company, the Board may appoint any person as a director nominated by any institution in pursuance of the provisions of any law for the time being in force or of any agreement or by the Central Government or the State Government by virtue of its shareholding in a Government company

Appointment of Directors by Tribunal: While giving order on an application made for relief in cases of oppression, the Tribunal may order for appointment of such numbers of persons as Directors of the company and ask them to report to the Tribunal on matters as the Tribunal may direct. The directors, so appointed, may or may not be the members of the company. While counting 2/3 or any other proportion of the total number of directors of the company, these directors will not be taken into account nor they shall be liable to determination by retirement of directors by rotation. But they can be removed by the Tribunal at any time and other persons can be appointed by it in their place. Where the directors have been appointed by the Tribunal, it may also issue such directions to the company, as it may consider necessary or appropriate in regard to their affairs.

Vacation of Office by Directors:

The office of a director shall become vacant in case –

- a) he incurs any of the disqualifications
- b) he absents himself from all the meetings of the Board of Directors held during a period of twelve months (date to date) with or without seeking leave of absence of the Board;
- c) he acts in contravention of the provisions, relating to entering into contracts or arrangements in which he is directly or indirectly interested;
- d) he becomes disqualified by an order of a court or the Tribunal;
- e) He is convicted by court of any offence, whether moral turpitude or otherwise and sentenced to imprisonment for not less than six months
- f) Retirement
- g) Resignation

Resignation of Director: A director may resign from its office by giving a notice with the reasons of resignation in writing to the company. The company shall within 30 days from the date of receipt of notice of resignation from a director, intimate the registrar and lay the facts of such resignation in the Report of Directors laid in immediately following general meeting by the company. The resignation is effective from the date on which the notice is received by the company or the date specified by the Director in the notice whichever is later.

Retirement of directors: In case of public company, unless it is provided by the articles, 2/3rd directors are liable to retire by rotation and 1/3rd are liable to retire at every general meeting after the meeting at which first directors are

appointed. 1/3rd directors which are liable to retire at AGM will be decided by First in First Out (FIFO) method.

The retiring Directors can be re-appointed by shareholders by casting votes in favour in excess of votes casted against the resolution.

Further, Independent Directors and Nominee Directors are excluded from the calculation of 2/3rd. A small shareholder director will always be a non rotational direction. He will be counted in 2/3rd but cannot be retired by rotation.

Removal of director: A company may, by ordinary resolution remove Director before the expiry of the period of his office irrespective of the fact how he was appointed or any provision to that affect in Article or any agreement.

By shareholder: shareholders may remove director, not being a director appointed by the Tribunal before expiry of his term. An application to this effect must be made by the shareholders along with the reasons for their action. And the Director must be allowed to make representation.

By the National Company Law Tribunal: Where an application has been made to the National Company Law Tribunal for prevention of oppression or mismanagement and the Tribunal has conducted its proceedings on the application, it has the power, to remove any Director.

Activity 4

- 1) Minimum ____ number of directors in public company and minimum ____ in private company
- 2) A Company can appoint maximum ____ Directors.
- 3) Listed public company must have ____ of the total number of directors as independent directors.
- 4) The maximum number of directorship that a person can hold ____
- 5) What is the provision for appointment of women director?

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- 6) Who is an additional director?

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4.6 MEETINGS

A company, since is not a natural person, is not endowed with the wherewithal of decision- making. The Board of Directors, according to prescribed system, come together to take decision on behalf of the company. This coming together as a decision-making body is called a ‘meeting’.

Kind of Meetings

Company meetings can be classified as follows:

- 1) Shareholders meeting
 - a) Annual General Meeting
 - b) Extraordinary General Meeting
 - c) Class Meeting
- 2) Board meetings
- 3) Creditors and Debenture holders meeting

Shareholders meetings:

- a) **Annual General Meeting:** The meeting to be held annually for seeking approval to certain 'ordinary business' is called Annual General Meeting (AGM). If the Board fails to convene its Annual General Meeting in any year, any Member of the company may approach the prescribed authority, which may then direct the calling of the Annual General Meeting of the company.
- b) **Extraordinary General Meeting:** All general meetings other than annual general meeting are called extra-ordinary general meetings (EGM). These are held to transact any business other than ordinary business.

EGM can be called by Board of Directors, or by the Board on requisition of shareholders, or by requisitionists themselves if Board does not proceed to call the same or by Tribunal.
- c) **Class Meeting:** It is a meeting of shareholders, holding a particular class of share. The resolution passed at this meeting bind only the members of the class concerned. Only members of the class concerned may attend and vote at meeting. These class meetings are convened whenever it is necessary to alter or change the rights or privileges of that class as provided by the articles.

Board Meetings:

"Meeting of Board" means a duly convened, held and conducted meeting of the Board or any Committee thereof. To be an effective Board meeting it requires to:

- have a purpose;
- members of the Board must be provided with adequate notice and appropriate materials in advance;
- be chaired effectively;
- follow proper meeting procedures and respect the time of Board Members;
- have clear supporting documents such as an agenda, minutes and other reports;
- have action taken reports;
- be documented with minutes.

First board meeting should be held within thirty days of the date of incorporation. Thereafter there shall be minimum four board meetings every year and not more than 120 days shall intervene between two consecutive Board meetings.

In case of one person company (OPC), small company, dormant company and private company which is startup, at least one Board meeting should be conducted in each half of the calendar year and the gap between two meetings should not be less than ninety days.

One third of total strength or two directors, whichever is higher, shall be the quorum for a Board meeting. The board cannot transact business without quorum, the meeting stands adjourned, unless the articles otherwise provide to be held to the same day at the same time and place in the next week or if that day is a National Holiday, till the next succeeding day, which is not a national holiday, at the same time and place.

The Chairman of the Company shall be the Chairman of the Board. If the company does not have a Chairman, the Directors may elect one of themselves to be the Chairman of the Board.

The Chairman of the Board shall conduct the Meetings of the Board. If no such Chairman is elected or if the Chairman is unable to attend the Meeting, the Directors present at the Meeting shall elect one of themselves to chair and conduct the Meeting, unless otherwise provided in the Articles.

Every company shall prepare, sign and keep minutes of proceedings of meeting of Board of Directors or of every committee of the Board within thirty days of the conclusion of the meeting. The minutes shall contain: (a) Name of the directors present at the meeting; and (b) In the case of each resolution passed at the meeting, the names of dissenting Director or a Director who has not concurred the resolution.

4.7 WINDING UP OF COMPANIES

Winding up of a company is a process by which the life of a company is brought to an end and its property administered for the benefit of its members and creditors.

As per Section 2(94A) of the Companies Act, 2013, the term “winding up” means winding up under this Act or liquidation under the Insolvency and Bankruptcy Code, 2016, as applicable. The procedures for Winding up of companies are provided under Chapter XX of the Companies Act, 2013, and the Insolvency and Bankruptcy Code of India, 2016.

There are two Modes of Winding Up:

- 1) Winding Up By the Tribunal
- 2) Voluntary Winding Up

1) Winding Up by the Tribunal:

A company may, on a petition under section 272, be wound up by the Tribunal—

- 1) if the company has, by special resolution, resolved that the company be wound up by the Tribunal;
- 2) if the company has acted against the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality;

- 3) if on an application made by the Registrar or any other person authorised by the Central Government by notification under this Act, the Tribunal is of the opinion that the affairs of the company have been conducted in a fraudulent manner or the company was formed for fraudulent and unlawful purpose or the persons concerned in the formation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith and that it is proper that the company be wound up;
- 4) if the company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding five consecutive financial years; or
- 5) if the Tribunal is of the opinion that it is just and equitable that the company should be wound up.

Petition for Winding Up to Tribunal can be made by

- The Company
- Any Contributory or Contributories
- All or any of the persons specified above
- The Registrar
- Any person authorized by Central Government in that behalf
- In case affairs of the company conducted against the nation interest, by the Central / State Government.

The Tribunal on receipt of a petition, for winding may within 90 days pass any of the following orders with :—

- a) dismiss it, with or without costs;
- b) make any interim order as it thinks fit;
- c) appoint a provisional liquidator of the company till the making of a winding up order;
- d) make an order for the winding up of the company with or without costs; or
- e) any other order as it thinks fit:

2) Voluntary Winding Up:

Chapter V of the Insolvency and Bankruptcy Code of India, 2016, deals with the Voluntary Liquidation of Corporate Persons. Voluntary liquidation proceedings can be initiated by a corporate person if it has not committed any default.

- a) a declaration from majority of the Directors of the company verified by an affidavit is required stating that—
 - they have made a full inquiry into the affairs of the company and they have formed an opinion that either the company has no debt or that it will be able to pay its debts in full from the proceeds of assets to be sold in the voluntary liquidation; and
 - the company is not being liquidated to defraud any person
- b) Within four weeks of a declaration at (a) above, there shall be in a general meeting—

- i) a special resolution of the members, to liquidated the company voluntarily and appointing an insolvency professional to act as the liquidator; or
 - ii) a resolution of the members, to be liquidated voluntarily as a result of expiry of the period of its duration, if any, fixed by its articles or on the occurrence of any event in respect of which the articles provide that the company shall be dissolved, as the case may be and appointing an insolvency professional to act as the liquidator.
- c) Provided that the company owes any debt to any person, creditors representing two thirds in value of the debt of the company shall approve the resolution passed within seven days of such resolution.
 - d) The company shall notify the Registrar of Companies and the Board about the resolution to liquidate the company within seven days of such resolution or the subsequent approval by the creditors, as the case may be.
 - e) Subject to approval of the creditors, the voluntary liquidation proceedings in respect of a company shall be deemed to have commenced from the date of passing of the resolution

Activity 5

- 1) What should be the frequency of Board meeting?

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- 2) Name the meetings classified as shareholders meetings.

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- 3) What is 'winding-up' of a company?

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.....

- 4) Name the different mode of winding-up.

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4.8 SUMMARY

The expansion in business needed an unlimited extent of capital. But the unlimited liability of the partners of the traditional partnerships under the Partnership Act, 1930 became a hurdle to meet the capital requirement. The corporate form of business helped to solve this problem through introduction of concept of limited liability. From formation to its winding up a company is governed by Companies Act.

The Companies Act, 2013, has broadly classified the companies into various classes. There are three fundamental documents of a company. They are:

- a) **Memorandum of Association** is the charter of a company which lays down the objects of the company and also all the specific functions, operations and limitations.
- b) **Articles of Association** is the document that constitutes all the rules and regulations for the conduct of the internal management of the company.

c) **Prospectus**

A public company raises the necessary funds by issuing Shares, Debentures, and by accepting Public Deposits.

Since a company is an artificial person its affairs are to be managed by natural persons. The management of corporation is a collective responsibility and those who manage the corporation are known by various names such as Director, Managing Directors, Secretaries, etc. The Board of Directors is a group of people elected by the shareholders of the company to represent their interests. The Board acts as a governing body for a company or corporation.

Since a company is not a natural person, the Board of Directors, according to prescribed system, come together to take decision on behalf of the company. This coming together as a decision-making body is called a 'meeting'. There are different kind of meetings held in the company by the Shareholders, Board, or by Creditors and Debenture holders.

Winding up of a company is a process by which the life of a company is brought to an end and its property administered for the benefit of its members and creditors.

4.9 SELF ASSESSMENT QUESTIONS

- 1) Explain the salient features of a company.
- 2) What is a one person company? State its salient features?
- 3) Write note on small company and Associate Company.
- 4) Explain section 8 companies.
- 5) Elaborate different stages in formation of a company.
- 6) What is the effect of registration of a company?
- 7) When and how a company can buyback its shares?
- 8) What are the disqualifications of a director?
- 9) In what circumstances the office of the director is vacant?
- 10) What are the provisions for holding a Board meeting?
- 11) Mention directives for Board Meeting
- 12) Explain the modes of winding-up of a company.

4.10 FURTHER READINGS

- 1) Avatar Singh, 2018, Company law, Eastern Book company
- 2) Taxmann's Companies Act with Rules, Taxmann, (2022)
- 3) Companies Act ,2013, Commercial Law Publishers, (2021)

BLOCK-3

BUSINESS CONTRACTS

Unit 5 General Principles of Contracts

Unit 6 International Contracts of Sale



UNIT 5 GENERAL PRINCIPLES OF CONTRACTS

Objectives

After studying this Unit, you should be able to:

- Identify different Sources of Mercantile Law
- Understand the process of Formation of Contracts
- Explain the completion of Contracts and Jurisdiction
- Appreciate essentials of Valid Contract and Performance of the Contracts
- Describe the consequences of Breach of Contract

Structure

- 5.1 Introduction
- 5.2 Sources of Mercantile Law
- 5.3 Formation of Contracts
- 5.4 Completion of Contracts and Jurisdiction
- 5.5 Essentials of Valid Contract
- 5.6 Performance of the Contracts
- 5.7 Doctrine of Frustration or Agreement to do an Impossible Act
- 5.8 Appropriation of Payments
- 5.9 Consequences of Breach of Contract
- 5.10 Summary
- 5.11 Self Assessment Questions
- 5.12 Further Readings/References

5.1 INTRODUCTION

Every human being owes certain obligations to his family members and society. These obligations fall under the Law of obligations that covers rights and duties arising between the individuals which are collateral in nature. The concept of obligations existed since the ancient period where the word of mouth was considered to create a bond. In other words, people will never leave from their words i.e., promises. The concept of primary obligations is one of humanity's greatest moral inventions. Wherever the promises are breached they will be brought before the panch system for resolving the dispute between the parties.

The law that is applicable to mercantile transactions is called the mercantile law which includes General Contracts, Special Contracts and the law of Insolvency and Bankruptcy. This law relates to the rights and obligations arising out of mercantile transactions between traders or merchants. The movable property connected with mercantile is of two types namely ***Choose in possession*** and ***Choose in action***. If person 'A' had a ring on his hand which is stolen by a thief, 'A' is a person having ***choose in possession***. In other words, it means an Individual who had legal possession of any property of movable nature and physically visible.

Person 'A' can resist the thief from snatching and recover it in a court of law. Recovering the amount due on a promissory note is considered *as choose in action*. This right of the payee or holder is not visible as compared to the ring. Further, it must also be noted that the law of Contracts is applicable even to non-mercantile transactions.

5.2 SOURCES OF MERCANTILE LAW

The main sources of Mercantile Law in England are: The Law of Merchant or *Lex Mercatoria*; Acts of Parliament or Statutes; Common Law of England and Principles of Equity. *Lex Mercatoria* is the set of customs and usages which are recognised and enforced between merchants and part of the *Common Law of England*. The second one is the sanction of the State and most superior and powerful source and it overrides any rule of Common Law of Equity. The phrase common law is used to denote the law that can be based on judicial pronouncements delivered from generations. King Henry II in 12th Century established the Common Law Courts or King's Courts which were also known as Chancery or Equity Courts. Equity courts were not bound to grant relief in every case, as it was always a matter in discretion and governed by certain maxims. There are two maxims which the courts of Equity act: "*he who seeks equity must do equity*" and "*he who comes to Equity must come with clean hands.*"

Prior to the Indian Contract Act, 1872, the English Common Law with some modifications suited to Indian conditions for some time in the British India Courts. After the Establishment of courts at Madras, Bombay and Calcutta the Hindu Law and Mohammedan law and the law of defendants are to be considered for the application of law.

The introduction of judicial system during the British India paved the way to introduce *a legislation to recognize and legalize the concept of obligations* and the practices among the people by the Contract Act, 1872. The principles of Law of contract are divided into four categories namely *the formation of the contracts, content of contracts, excuses for non-performance, and enforcement of contracts.*¹

5.3 FORMATION OF CONTRACTS

A contract is an **agreement** enforceable in a court of law. An agreement is a set of reciprocal promises between the parties to the contract. These set of promises arises from an **offer** and **acceptance** from the parties to the contract.

The contract may be express or implied i.e., it may be oral words or in writing and even inferred from the conduct of the parties.² It may be bilateral or unilateral contract. The former one refers to the involvement of two parties and the latter refers one party alone can perform without the other.

Agreements: Two or more persons agree mutually to undertake to do or not do certain things through an agreement, for example, to deliver goods and to pay for them. This is not through a process of offer and acceptance.

Offer: The offer is a proposal by the offeror to undertake to do or abstains from doing something provided the offeree will also undertake to do or abstains from doing something.³ The offer contains two things namely '*an expression of a*

willingness to be bound' and 'a statement of what each party to the proposed agreement must do or not to do.' The person making the proposal is said to be called as 'Promisor', 'Offeror,' or 'Proposer.'⁴ The offer is of two types namely *specific offer* and *General offer*. An offer to a specific person is specific offer and the offer to public at large is general offer. 'A's offer to sell his watch to 'B' is specific and 'X' offer to pay Rs.1,000/- to one who finds his lost dog is the example of general offer.

Acceptance: The person to whom the proposal is made signifies his assent thereto, the offer/proposal has been accepted and which raises a promise.⁵ The person to whom the proposal is made or the person from whom the promisor seeks the assent is said to be called as 'Promisee' or 'Acceptor.'⁶

Example: When 'A' signifies his willingness to sell his motor cycle for Rs.55,000/- to B, and B express his willingness to purchase for the said price, A is the proposer/ promisor or offeror and B is the promisee/acceptor.

The proposal/offer/promise must possess the following characteristics:

- 1) **It must be intended and capable of creating legal relationship between the parties to give rise to legal consequences:** The set of promises rise between the parties must create legal relations. In the above example, if A does not deliver the vehicle after receiving the price or if B does not pay the price, the other party having right for breach of promise/obligation undertaken by the party in the offer/acceptance as the case may be. The set of promises between parties which are not capable of giving rise to legal relationship or those which are not enforceable in a court of law are called as social obligations/agreement. If a person makes a promise to his friend to take him to dinner at a restaurant and the other agrees and if the promisor failed to perform his obligation, the promise could not be enforceable in a court of law as it was a social obligation. In other words, the social obligations through set of promises are incapable of giving rise to create legal relations between the parties.⁷
- 2) **The terms of it must be certain or capable of being certain:** The terms of the offer must be certain i.e., without ambiguity or vagueness. In other words, the person to whom it was made must be in a position to understand and respond with his assent.
- 3) **It must be different from the following:**
 - a) **Quotation, catalogue, Auction, Tenders etc.:** These are regarded as invitation to make an offer for a particular thing specified therein by the person who gave the quotation /catalogue. Calling for tenders and auctioning of goods also come under invitation to make offer.
 - b) **Window displays at show rooms:** This is also considered as an invitation to make an offer by the showroom owner from the public.
 - c) **Railway timetables:** Issuing of ticket by the Railway authorities against payment to a commuter is amounting to an offer but the time tables of the railways not regarded as an offer.
- 4) **It must be offered to an individual or to the public at large:** The offer is of two types namely specific offer and General offer. An offer to a specific

person is specific offer and the offer to public at large is general offer. A's offer to sell his watch to B is specific and X offer to pay Rs.1,000/- to anyone who finds his lost dog is the example of general offer.

- 5) It must be communicated to the offeree:** The offeror is having obligation to communicate to the respective offeree within reasonable time and manner.

In order to convert a proposal into a promise, the acceptance must be absolute and unqualified.⁸ It must be expressed in some usual and reasonable manner. If the acceptance is conditional the promisor can withdraw the proposal before the acceptance becomes absolute. Performance of the conditions of the offer or acceptance of any consideration for reciprocal promise which may be offered with a proposal is an acceptance of proposal.⁹

Essentials of valid acceptance:

- 1) The acceptance is not valid if it was communicated in the manner otherwise than mentioned in the offer. English law invalidates such acceptance. But Indian law¹⁰ says that after receiving the acceptance in different manner, the receiver must inform the acceptor that your acceptance is not accepted unless and until it is communicated in the specified manner, failing which the proposer accepts the acceptance.
- 2) The offeror may waive the communication of an acceptance.¹¹
- 3) Acceptance must be made before the offer lapses or revoked by the proposer.
- 4) It should be absolute in terms with the offer. Variation or addition of terms to the original offer is not valid acceptance. A statement of fact to an offer does not amount to acceptance.¹²

Lapse or revocation or rejection of offer: The proposal of the offeror lapses on the death of the proposer and before the offeree accepts. There will be no contract in English law even the acceptance was made in ignorance of the death of the offeror. But under Indian law, there will be a valid contract except where the acceptance is made with knowledge of the death of the offeror.¹³ This rule will be applicable in case of insanity of the offeror also.

If the offeree does not respond to the offer in the manner prescribed or within reasonable time there will be no contract. The term '*reasonable time*' is used in wider sense which varies from the circumstances of each case.

The offeror is at liberty to revoke the offer by communication at any time before the offeree makes the acceptance of it. Even if the offer is valid for a fixed term or period; the offeror can communicate the revocation of the offer before the offeree accepts.

The offeree can communicate his rejection to the offeror or he may make counter offer or he may accept with certain conditions.

5.4 COMPLETION OF CONTRACTS AND JURISDICTION

Generally, the contract completes when the acceptance of the offeree is posted or put in to transmission. It was made at the place where the acceptance is received

by the offeror. It was easy to determine the completion of contract when the parties negotiate in person. But it will be difficult to determine in case of negotiation by *post, telegram, telephone and mail*, etc. The contract in case of instantaneous contracts completes only when the communication of the acceptance is received by the offeror. In other words, the contract is said to be made at the place where the acceptance received but not at the place where it is transmitted.¹⁴

The United Nations Commission on International Trade Law (UNCITRAL) adopted the Model Law on Electronic Commerce in 1996. As a result the Information Technology Act, 2000, governs the rules relating to the e-commerce contracts. The offeror and acceptor are substituted by expression *soriginato*¹⁵ and *addressee*. The electronic record sent by the originator may be received intact or it may vary. The addressee has to acknowledge the receipt of electronic record by communication automated or any mode or by conduct.¹⁶ The contract completes where the principal place of business of the originator, in case of more than one place of business of originator or addressee the principal place of business of the originator or addressee and in case of no place of business his usual place of residence will be considered as the completion of the contract for the purpose of jurisdiction.¹⁷

5.5 ESSENTIALS OF VALID CONTRACT

Consideration, capacity to contract, free consent, and legality of consideration and object are some of the essentials of a valid contract. These are explained in detail below:

1) *Consideration*:

Consideration is one of the essential conditions for the validity of contract.¹⁸ The essential condition for the enforceability of simple contracts is *consideration*, and the rule is expressed by the ***Latin maxim***: *ex-nudopacto non oritur actio* which means out of nude pact no cause of action arises. It can be understood in the sense *quid pro quo*.

“A valuable consideration in the sense of the law may consist either some right, interest, profit or benefit accruing to one party, or some forbearance, detriment, loss or responsibility, given suffered undertaken by the other.”¹⁹

“An act or forbearance of one party or the promise thereof, is the price for which the promise of the other is brought and the promise thus given for value is enforceable.”²⁰

“When at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing, or promise to do or abstain from doing something, such act or abstinence or promise is called a consideration for the promise.”²¹

The analysis of the above definitions says that the consideration may be executed or executory. In a contract to deliver a watch by A to B for Rs.100, A and B gained money and watch and in another stand point A and B lost watch and Rs.100, respectively. The law insists more upon the presence of the element of detriment to the promisee B and then the presence of benefit to the promisor A.

A promise from one party to the other and a promise from the other to the former support the consideration. In other words, the reciprocity of promises between the parties establishes the consideration.

The absence of consideration makes the contract void.²² This principle has certain exceptions recognized under the provisions of law. They are:

- i) Where the contract reduced in to writing and registered and made out of natural love and affection between the parties standing in near relationship to each other.
- ii) Where the contract is to compensate the person who voluntarily rendered services in past. In other words, past services rendered at the desire of the promisor constitute a valid consideration in India.²³ But under English law past consideration is not valid.
- iii) Where a promise is made to pay a time-barred debt does not require a fresh consideration.
- iv) Where a gift between the donor and donee is not affected for want of consideration if it is registered and attested by two witnesses.

Though consideration is necessary it need not be adequate. The adequacy and sufficiency of consideration is immaterial. It is said that pepper corn is sufficient for purchase of an elephant.

The consideration is to move from whom is the question to be determined for the enforceability of the contract. It must proceed or move from the promisee. Under English law a stranger to a consideration cannot sue. In other words, the promisee cannot sue the promisor if the consideration doesn't move from him. But under Indian law, a stranger to consideration can sue.

The rule stranger to contract cannot sue is the same both under English law as well as under Indian law. This principle was explained by the doctrine of *Privity of Contract*.²⁴ Under English law there are certain principles which are fundamental. A person who is a party to the contract can sue on it. This principle has certain exceptions recognized by the provisions of law, as stated hereunder:

- a) Where a trust is created for the benefit of a party, the beneficiary can enforce it though he is a stranger to contract.²⁵
- b) Where there is an acknowledgement of liability or estoppel. For example, 'A' receives money from 'B' to pay it to 'C', 'A' admits to 'C' the receipt of this amount and liable to pay it to 'C'.

Apart from the above the Indian law recognizes two more exceptions:

- c) A benamidar in whose name a property was registered is entitled to enforce though he is not a party to the contract.
- d) In family arrangements such as maintenance or expenses for marriages of female members, the beneficiaries can sue though they are not party to the contract.

Consideration and Discharge of Contract:

The doctrine of consideration is not extended to the discharge of contract. The reciprocal promises between the parties constitute consideration. Subsequently,

if both the parties agree not to enforce the contract also constitute consideration in India. But it is not so in English law. Till 1947 the law of England applied the doctrine of consideration not only to the formation of a contract, but also to its discharge. It was pointed out that a creditor '*might accept anything in satisfaction of his debt except a less amount of money*'²⁶ A canary or pepper corn may be accepted in full discharge of a debt, but a part payment of the debt cannot be accepted so as to operate as full discharge of the debt. The following are the exceptions to the rule in *Pinnel's* case.²⁷

- a) Under the scheme of composition if the debtor agrees to pay a portion of the debt discharges liability without application of the doctrine of consideration under English law.
- b) In case a third party pays a part of the amount less than the amount due from the debtor discharges the debtor without application of the doctrine of consideration under English law.
- c) The doctrine of estoppel or quasi-estoppel neutralized the rule in *Pinnel's* case.²⁸

Under Indian law, a contract may be discharged by what is called "*an accord and satisfaction*" i.e., mutually agreed settlement.²⁹ The English law allows the delivery of horse against the payment of debt but not accept the delivery in future to discharge the debt. The part payment of debt is also not accepted as accord and satisfaction.

2) *Capacity to Contract:*

There are certain persons in law who are incapable wholly or in part, of binding themselves by a promise or of enforcing a promise made to them. In mercantile contracts *lex loci contractus* i.e., the law of the place will prevail whereas in case of land *lex situs* i.e., the law of the place where the land situate will be applicable. The incapacity of a party to enter into a contract will arise in two ways namely, on account of status, or on account of mental deficiency. The former would occur on the grounds of political consideration and expediency, the latter is imposed to protect the interest of the disabled person.

The incapacity of a party is broadly divided into two;

one which arises out of status of an individual for the following reasons:

- a) Political or Civil status e.g., where the contracting party is a ruler of a foreign state, Ambassador or envoy or alien enemy, or a convict or a bankrupt.
- b) Profession of the contracting person e.g., barrister
- c) Incorporation
- d) Marriage

The **other** which arises from mental deficiency (soundness of mind) of the person contracting in case of:

- a) Minors
- b) Insane persons
- c) Idiots
- d) Drunken persons

The person below the age of 21 is called as an infant as per the Infant Relief Act, 1874 under the Common Law and the person below the age of 18 is a minor as per the Family Reforms Act, 1969, under English law and Indian law respectively. He is a person who is not a major. The Infant Relief Act, 1874 which modified the Common Law of England allows an infant to enter into a contract for the following:

- a) For necessities
- b) Beneficial contracts of service
- c) Contracts involving recurring rights and duties e.g., an interest in property binding on him unless he rescind them either during infancy or within reasonable time of becoming a major
- d) An isolated act or a contract to pay for goods supplied other than necessities, were voidable and not binding on him unless he ratified them within reasonable time after attaining majority.

The law relating to infants/minor contracts is at present provided in Minor's Contract Act, 1987, under English law.

The Indian contract Act, 1872, provides that the contracting party must be a major.³⁰ A person becomes major on attaining the age of 18 years.³¹ The provision of the Contract Act does not specify whether a minor's contract is void or voidable. The analogy of English law made such contracts as voidable and becomes valid by ratification on attaining majority. The *Privy Council* in *Mohori Bibi v. Dharmadas Ghose*³² pointed out this erroneous view and held that a minor's contract is *void ab initio*. There will be no question of avoiding it or ratifying it. Similar to English law the person supplying necessities to minor is protected under Indian law.³³ The binding nature of a guardian contract on the minor is depending on the legal power of the guardian to enter into a contract or not. There will be no estoppel against a minor as both the parties are aware of the truth. The power to order restitution in India is wider than England. It was clear under Indian law that any benefit, even cash received, may be directed to be restored. But it must be shown that the minor or his estate derived some benefit therefrom.³⁴

Mutuality of mind: The parties to the contract must have *consensus-ad-idem*³⁵ which means mutuality of mind as to the subject matter of the contract. The lack of mutuality of mind makes the contract void. 'A' had two houses namely 'X' and 'Y'. 'A' enters into contract with 'B' to sell keeping 'X' house in his mind and 'B' entered into contract with 'A' by keeping 'Y' house in his mind. This results the contract void due to lack of *consensus-ad-idem* on the subject matter of the contract.

3) **Free Consent:**

"The consent of the party to the contract is said to be free³⁶ if it is not caused by; coercion, undue influence, fraud, misrepresentation and mistake. These are explained hereunder:

- i) **Coercion:**³⁷ "The committing, or threatening to commit, any act forbidden by the Indian Penal code, or the unlawful detaining, or threatening to detain, any property to the prejudice, of any person whatever, with the intention of

causing any person to enter in to an agreement.” The term *duress* in English law defined as causing, threatening to cause, bodily violence or imprisonment, with a view to obtain the consent of the other party to the contract. *Coercion* in Indian law has a much wider connotation than *duress* in English law. The main distinction between *coercion* and *duress* as the first denotes the offense forbidden by Indian Penal Code whereas the latter confined only to bodily violence and imprisonment. The presence of *coercion* or *duress* in both Indian and English law was an invalidating element for the enforceability of contract.

ii) **Undue Influence.**³⁸ This was also called as constructive fraud. It covers all the contracts where one party will be in a position to dominate the will of the other because of relationship while entering the contract. This influence can be presumed in existence among the following relationships:

- a. Parent and child b. Guardian and ward
- c. Trustee and beneficiary d. Spiritual master and Disciple
- e. Lawyer and client f. Doctor and patient

The contract between the parties with above relationship turns it voidable by presuming the existence of undue influence of the former against the other. It is the burden on the former party to prove that he was not in dominating position and that his position was not used to obtain the consent of the other.

iii) **Fraud.**³⁹ The following acts of a party to a contract establish fraud while entering into a contract with the other:

- a) the suggestion of a fact, of that which is not true by one who does not believe it to be true
- b) the active concealment of a fact by one having knowledge or belief of the fact
- c) a promise made without intention of performing it;
- d) any other act fitted to deceive
- e) any such act or omission as the law specially declares as fraudulent.

The mere silence on the part of party does not amount to fraud. But silence amount to fraud where there is a duty on the party to speak.

iv) **Misrepresentation.**⁴⁰ A party may give his consent to enter into a contract because of misrepresentation of the other. These false statements or misrepresentations may be either inducing cause of contract. These statements may be called as innocent misrepresentation and willful or actionable misrepresentation which amounts to fraud.

A misrepresentation consists of the following ingredients:

- a) Failure to disclosure of a fact
- b) Such non-disclosure must relate to a fact not to an opinion
- c) Such representation must be untrue
- d) It must be material to influence the other to enter into a contract

Any representation made by a party with full knowledge of the fact that it is

not true, or without belief in its truth or recklessly, not caring whether it is true or false, it is said to be fraudulent.⁴¹

Whenever the consent of the party is obtained in the absence of free consent the contract is voidable at the option of the party whose consent is not free because of the presence of coercion, or fraud, or misrepresentation. The aggrieved party of such voidable contract had an option to continue the contract or rescind the contract⁴² and entitled for damages. Further, the contract induced by undue influence can be set side or it is voidable at the option of the party whose consent was obtained by dominating the will of the aggrieved party.⁴³

- v) **Mistake:**⁴⁴ While entering into a contract the parties to the contract may be under a mistake. This mistake may be as to a fact or law. Mistake of fact may be as to subject matter of the contract e.g., regarding the existence, quality or quantity etc.; nature of contract; person entering into contract. Mistake of law may be regarding foreign law, or ordinary law, law of our country, or private rights of the contracting parties. Another classification of these mistakes is bilateral and unilateral.

A mistake of fact in the minds of both the parties negatives the *consensus ad idem* and the contract in such cases is void. Where both parties to an agreement are at mistake as to a matter of fact essential to the agreement, the agreement is void.⁴⁵ This will come under the classification of bilateral mistake.

In case of unilateral mistake, i.e., where only one party to a contract is under a mistake, the contract, generally speaking, is not valid. A contract is not merely voidable because it was caused by one of the parties to it being under mistake as to a matter of fact.⁴⁶

A contract is not voidable because it was caused by mistake as to any law in force in India but a mistake as to a law not in force in India has the same effect as a mistake of fact.⁴⁷

4) **Legality of Consideration and Object:**

Apart from the above essentials for the formation of a valid contract **the legality of consideration and object**⁴⁸ is must. The unlawful agreements may be classified as follows:

- 1) *Illegal*-where the agreement is contrary to the statute law
- 2) *Immoral*- where it is opposed to public morals e.g., agreement for illicit cohabitation, or separation between husband and wife
- 3) *Opposed to public policy*- where the agreement is forbidden as conflicting with the well-being of the state e.g., agreements tending to the abuse of legal process, agreements in restraint of trade, agreements in restraint of marriage, agreements in restraint of parental rights, etc.

Where a part of consideration or object of an agreement is unlawful the agreement is void. In case of non-separation of the unlawful part from the agreement the total transaction will be void. The rule applicable to separate the unlawful and lawful part is known as *blue pencil rule*. In such cases the lawful part which

separated by drawing blue pencil lining from the unlawful part can be enforceable.⁴⁹ A contract without consideration is said to be void with certain exceptions;⁵⁰

- a) Every agreement in restraint of marriage of any person, other than a minor is void.⁵¹
- b) An agreement in restraint of trade is void with an exception where goodwill is sold or as per the provisions of the Partnership Act, 1932.⁵²
- c) Any agreement in restraint of legal proceeding is void with an exception of arbitration agreement.⁵³
- d) Where the meaning of an agreement is not certain, or capable of being certain are void.⁵⁴
- e) Agreement by way of wager is void.⁵⁵
- f) The performance of the contract is depending on the happening or non-happening of an event at a future date is called as contingent contract.⁵⁶ If the happening of the event is impossible the contract becomes void.⁵⁷
- g) The enforcement of a contingent contract is possible before the impossibility of its occurrence.⁵⁸ The promise of A to pay B a sum of money if B marries C. C marries D. Marriage between B and C is impossible during the life time of A makes the agreement void.⁵⁹
- h) The contingent contract to do or not to do within a specified becomes void after the expiry of the time.⁶⁰
- i) Any agreement contingent on impossible events is void.⁶¹

5.6 PERFORMANCE OF THE CONTRACTS

Both the parties to the contract either perform, or offer to perform their respective promises until such performance is dispensed with or excused under any provisions of this Act or any other law in force. Even the death of one of the party makes his legal representatives liable unless the intention of the parties to the contract differs.⁶² The promisee's non-acceptance of offer of performance of the promisor, the promisor is not responsible for the performance, nor does he lose his rights under the contract subject to the following conditions:⁶³

- a) The offer must be unconditional.
- b) It must be made at a proper time and place, and in the circumstances that the person to whom it is made must have a reasonable opportunity to ascertain that the person is able and willing to do i.e., accept
- c) If it is the delivery of anything to the promisee, he must have an opportunity of seeing the delivered thing which the promisor is bound by his promise to deliver.

In case of anticipatory breach of contract by the promisor, the promisee may put an end to the contract, and sue for damages immediately though he had a right to keep open the contract until the performance is actually due.⁶⁴ Keeping the promise alive may lead the promisor to take advantage of supervening circumstances.

The performance may be by the person who makes the promise, the promisor or his representatives may employ a competent person to perform depending on the intention of parties to the contract.⁶ If the performance from the third person is accepted by the other party, later the promisee can't enforce against the promisor.⁷

When the promise is made jointly, it is to be performed by all such joint promisors during their living and after the death any of them, his representative jointly with surviving promisor. After the death of the last survivor, the representatives must fulfill the promise jointly. This is subject to a contrary condition of the contract.⁶⁷ The promisee may compel one of the joint promisor to perform in the absence of express agreement to the contrary. On such performance by one of the promisor he can compel the other promisor to contribute. In an occasion where one of the promisor failed to contribute the remaining promisors has to share the loss of contribution.⁶⁸ This is also subject to a contrary appears in the language of the contract. The release of the joint promisor from performance does not discharge the other from liability. There is a point of difference in English law and Indian law. In India, they are presumed to be jointly and severally liable.⁶⁹ When a party makes a promise to two or more persons, the right to claim the performance rests between him and them, with them during the life time of the parties and on the event of death of either party, between the representative and survivor/representative as the case may be, with joint promisee or survivor/representative or representatives.⁷⁰ This is subject to a contrary condition of the contract.

Time and Place of Performance:

When the promisor has to perform without the application of the promisee, and no time is specified in the contract to perform, the performance must be done within reasonable time. What is reasonable time is a question of fact?⁷¹ When the time is specified but no application to be made by the promisee, the promisor may perform it any time during the usual hours of business on such day, and the place at which the promise ought to be performed.⁷² It is the duty of the promisee to make the application for performance on certain day to be at proper time and place during the usual hours. What is proper time and place is a question of fact?⁷³ It is the duty of the promisor to make an application to the promisee as to the time and place to perform when a promise is to be performed without application.⁷⁴ The promisee may prescribe or sanction the manner, the time and place of performance.⁷⁵

Performance of Reciprocal Promises:

In case of existence of reciprocal promises, the promisor needs to perform only when the promisee is ready or willing to perform his part of promise in the contract.⁷⁶ The reciprocal promises are to be performed as per the order specified in the contract, in the absence of such specification of order they must be performed in the order of the transaction requires.⁷⁷ The party preventing the other ready to perform his part of the reciprocal promise, the contract becomes voidable at the option of the party so prevented; he is entitled for compensation for loss because of non-performance of the contract.⁷⁸ The order of the performance of the reciprocal promises in the sequence as specified. The non-performance does not entitle the performance of the reciprocal promise and must make compensation to the other party for any loss because of his non-performance of the contract.⁷⁹ The performance to do a thing at or before specified time has to be performed accordingly. Failing which the contract becomes voidable in case the contract specifies the time is essence of the contract. The intention of the

contract does not specify time as essence of contract, the contract is not voidable and the promisee is entitled for compensation for any loss because of non-performance of the contract.⁸⁰ If the promisee agreed the acceptance of performance by the promisor other than at the agreed time, he can't claim damages for the delay in performance. However, he is entitled for compensation if he gives notice to the promisor of his intention to do so at the time of acceptance.⁸¹

5.7 DOCTRINE OF FRUSTRATION OR AGREEMENT TO DO AN IMPOSSIBLE ACT

The agreement between two parties to do an impossible act itself is void. A contract may also void because of an event which makes the performance of promise impossible or unlawful after the completion of the contract. Any person who makes promise to perform by knowing it to be impossible or unlawful is liable to pay compensation to the promisee that is not aware of impossibility or unlawful nature of the contract at the time of arriving it.⁸² This is known under the doctrine of frustration. This will be applicable in two classes of cases:

- 1) Where a supervening event makes the performance of a contract impossible
- 2) Where a supervening event or events have frustrated the object of both the parties and the changing circumstances the promise fails to be performed.

The dislocation of business in the wake of the first and second World Wars brought before courts a large number of 'frustration cases' and it has now been recognized the term 'frustration' includes the cases of 'impossibility' as well as the 'frustration of adventure.'

Supervening impossibility:

The very object of the subject-matter relating to the contract disappears; the contract is discharged by frustration on the ground of destruction of subject matter. A contract is also considered as frustrated in case of non-occurrence of expected events. The musician who failed to perform a concert due to illness as agreed in a theatre was held to be frustrated and so discharged by supervening impossibility.⁸³ The requisitioning of land by government for military purposes from the contract of sale of land by a company which undertook to construct drains and roads on the land to make it suitable for residential purpose is not considered as supervening impossibility as it was a temporary interruption and does not discharge the parties from the performance of the contract.⁸⁴

Supervening Illegality:

The contracts entered with the enemy nationals prior to the outbreak of war are suspended during the war and revived after restoration of peace only if it is not a continuous mutual duty between the parties. The changes in law also make the contract unlawful and the performance of the contract impossible. The judiciary expressed different theories for the judicial basis on the subject. The *implied theory* propounded by *Viscount Simon* says that no term could be implied to put an end to the contract in those circumstances.⁸⁵ According to the *disappearance theory*, if the foundation of the contract disappears either by the destruction of the subject-matter or by reason of interruption of performance, it must be regarded as frustrated. In case of *Just and reasonable solution theory*, even the express term in the contract render the performance impossible, and the contract purporting

to be alive, courts may hold the parties discharged from liability under the doctrine of frustration.

Doctrine of frustration limitations:

The party who himself responsible for frustration can't invoke the doctrine. This doctrine is not applicable to leases. In England, this doctrine is not applicable to the contract of sale of land as the buyer becomes the equitable owner of the property. In India, there is no equitable estate as such and so the doctrine is applicable even to contracts for sale of immovable property.⁸⁶

When there are two sets of reciprocal promises between the parties, one is legal and the other is illegal based on the circumstances, the legal one becomes a valid contract and the other is a void agreement.⁸⁷ In case of alternative promise, the legal one can be enforced and the other is void.⁸⁸

5.8 APPROPRIATION OF PAYMENTS

When the payment is made by the debtor, the payment has to be remitted by the creditor towards the amount outstanding as suggested by the debtor.⁸⁹ If the debtor not specified to which debt the payment is to be adjusted, the creditor had a right to pay even the time-barred debt also.⁹⁰ Neither the debtor or creditor appropriated the payment made by the debtor; the payment must be adjusted towards the first debt which is outstanding between the creditor and the debtor.⁹¹ The above rules for the appropriation of payments are known as *Rule in Clayton's case*.

Contracts which need not be performed:

The original contract between the parties need not be performed in case of *novation, rescission and alteration* of such contract. If the parties agree to substitute a new contract instead of the original one, or to rescind or to make an alteration of the contract, the parties to the original contract need not perform the obligations therein.⁹² The promisee is at liberty to dispense with performance of the promisor wholly or partly or extend the time of performance or may also accept instead of it any satisfaction which he deems just.⁹³ When a person having the option of rescinding the voidable contract, exercises his option to rescind the other party need not perform his part of promise in the contract.⁹⁴ Further, the party rescinding receives any benefit under voidable contract is liable to restore the benefit to the other. When a contract becomes void afterwards, the party deriving benefit or advantage of such contract is under obligation to restore it.⁹⁵ In case of rescission of a voidable contract, the party exercising the option must communicate the rescission of contract in the same manner as followed for communication of the revocation of the proposal.⁹⁶ The neglect or refusal of the promisee to afford the reasonable facilities for the performance of the promisor, the promisor is excused for the non-performance caused thereby.⁹⁷

Of certain relations resembling those created by contract:

These are also called as *implied contracts or quasi-contracts or Constructive contracts* which are created by lawyers and judges, based on certain equitable considerations. The early common Law of England had only two kinds of remedies: contractual and delictual. The absence of contract, the remedy could only be in tort. *Quasi* is a *Latin* term which means '*as if*.' In quasi contracts, there will be no actual contract between the parties but the law attributes to a

particular situation consequence which is similar to that of a contract. Action of account is the early quasi-contractual liability. This was available against Bailiffs, receivers and guardians who had to account for money kept with them. The 14th and 15th century extend to every case where money is paid to the defendant by a third party to the use of plaintiff. The underlining principle to determine the liability of the defendant is unjust enrichment at the expense of plaintiff. The equity courts applied the principle of preventing unjust enrichment in evolving the concept of trust.

There is no exact definition of a quasi-contract given anywhere even in the Contract Act. Those given by Dr. Winfield⁹⁸ and Dr. Jenks⁹⁹ may be accepted in the absence of a better one. 'A' delivers goods to 'B' without any contract either expressly or in writing. 'B' consumed the goods delivered by 'A'. The obligation of 'B' to pay 'A' the price arises from his promise implied by his conduct. This kind of contract is called a tacit contract. Similarly, if 'A' delivers to 'C' assuming him to be 'B', and 'C' consumed them, the obligation of 'C' to pay compensation to A for their value. This is quasi or implied contract.

The following are the examples of quasi-contract:

- 1) **Action for money had and received:**¹⁰⁰ This was based on the equitable principle that no person shall enrich himself at the expense of the other. Even the payments made under mistake of law may be recovered. The payment made under coercion is also recoverable under this principle.
- 2) **Money paid to plaintiff for use of defendant:**¹⁰¹ Where tenant A pays the taxes due from his landlord B to C in order to protect his possession from being processed against in execution of B's debt. In such cases, there is an obligation on B to repay the amount paid for his benefit. The enforcement of obligation under this head depends on two conditions namely the payment must be bonofide to protect his interest and it should not be a voluntary one.
- 3) **Quantum meruit:**¹⁰² The person derived benefit from an act of another has to compensate the other even there is no contract or invalid contract. This was based on the principle of *quantum meruit* which means 'as much as he deserves.' The compensation is subject to the fact that the delivery of goods is not made gratuitously and the defendant enjoyed the benefit.
- 4) **Obligation of finder of last goods:**¹⁰³ Though there is no contract between the finder and loser of the last goods the finder is having an obligation to return the goods find to the owner as a bailee.
- 5) **Necessaries supplied to a person incapable of contracting:**¹⁰⁴ This will discuss the contractual liability of a minor or lunatic to whom the necessaries are supplied which are suited to his condition of life. The person supplied necessaries entitled only to the property of the incapable party but he can't make him personally liable for the dues of the supply.

5.9 CONSEQUENCES OF BREACH OF CONTRACT

Any party who is responsible for breach of contract is liable to pay damages/ compensation to the other party who suffers loss because of non-performance by the other. In other words, the party aggrieved by the default of performance of

the other's obligation leads to breach of contract and entitles him for compensation. There were two remedies available in case of breach of contract by a party.

- 1) ***Common Law Remedy, i.e., damages***: The remedy of damages, therefore, only tries to evaluate in terms of money, the loss which a party sustains as a result of breach of contract.
- 2) ***Equitable Remedy, i.e., specific performance of contract, injunction, rectification and cancellation, etc.***: Keeping in mind that Specific performance is not available in every case, subject to several limitations; there is no other alternative for courts than to award damages which, of course, is available in every case.

Measure of damages is the value of performance of the contract to the plaintiff, and not what it costs the defendant to perform it.

There are four kinds of damages:

- A) ***General, or ordinary, or substantial damages***:¹⁰⁵ These are the damages which are to be paid as a consequence of breach of contract. In other words, it means the natural following consequences out of breach.
- B) ***Special damages***:¹⁰⁶ These are the damages which are to be paid for the loss of the profit in case of breach of contract of sale by the buyer. In other words, it was a kind of damages which are to be paid on account of usual or extra ordinary circumstances of the case.
- C) ***Vindictive, or Punitive or Exemplary damages***: These are awarded with a view to punish the defendant. Generally, vindictive damages are not awarded in case of contracts, but will be awarded in actions in tort. But they may be awarded in contracts like breach of contract to marry and the breach of payment of the customer to honor the cheque.
- D) ***Nominal damages***: These are paid in case of technical violation but no substantial loss. Proof of damage necessary even for claiming nominal damages.

The English law on the question of damages is laid down in *Hadely v. Baxendale*.¹⁰⁷ The following are the rules relating the award of damages for breach of contract:

- 1) The injured party is to be placed in the same financial position as if the contract has been performed.
- 2) Damages which are fair and reasonable arising from breach of contract can be recovered.
- 3) Damages which are contemplated in the contract at the time of contract¹⁰⁸ can be recovered though they are not naturally arising. These are called as liquidated damages.
- 4) Damages which will not fall under 2 or 3 above, but arise of special circumstances called special damages are not recoverable, unless they are brought to the notice of the other party before the contract is made.
- 5) It is the duty of the aggrieved party to minimise the damages.

- 6) It should not be more than agreed amount of the damages.
- 7) The injured is not disentitled to damages because of difficulty to assess them.
- 8) Vindictive or exemplary damages can't be awarded, except for the breach of contract of marriage.
- 9) The party rightfully rescinding the contract on the non-performance of the other is entitled to compensation,¹⁰⁹

5.10 SUMMARY

The law that is applicable to mercantile transactions is called the mercantile law which includes General Contracts, Special Contracts and the law of Insolvency and Bankruptcy. This law relates to the rights and obligations arising out of mercantile transactions between traders or merchants. Prior to the Indian Contract Act, 1872, the English Common Law with some modifications suited to Indian conditions for some time in the British India Courts.

A contract is an agreement enforceable in a court of law. An agreement is a set of reciprocal promises between the parties to the contract. These set of promises arises from an offer and acceptance from the parties to the contract. The contract may be express or implied i.e., it may be oral words or in writing and even inferred from the conduct of the parties. It may be bilateral or unilateral contract. Generally, the contract completes when the acceptance of the offeree is posted or put in to transmission. It was made at the place where the acceptance is received by the offeror. It was easy to determine the completion of contract when the parties negotiate in person.

Consideration, capacity to contract, free consent, and legality of consideration and object are some of the essentials of a valid contract.

The agreement between two parties to do an impossible act itself is void. A contract may also void because of an event which makes the performance of promise impossible or unlawful after the completion of the contract.

5.11 SELF ASSESSMENT QUESTIONS

- 1) Discuss the origin and sources of Mercantile Law.
- 2) Explain the formation of contract.
- 3) Describe the completion of contract and jurisdiction.
- 4) What are the essentials of a contract?
- 5) Briefly give a not on the capacity of party to the contract.
- 6) Critically analyze “a contract without consideration is void.”
- 7) When consent is said to be free?
- 8) Differentiate valid, void and voidable contracts.
- 9) Elucidate the performance of the contract and the reciprocal promises.
- 10) ‘Time is not the essence of contract.’ Comment.
- 11) How is the doctrine of frustration applicable in a contract?

- 12) Define the applicability of rule in Clayton's case for the appropriation of payments.
- 13) State the contracts which need not be performed or discharge of contract.
- 14) Enumerate the obligations which resemble the contracts under the head quasi-contracts.
- 15) Mention the consequences of the breach of contract.

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- ⁵⁰ See supra note 22
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- ⁵⁶ Section 31 of the Indian Contract Act, 1872
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- ⁵⁸ Section 33 of the Indian Contract Act, 1872
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- ⁶⁰ Section 35 of the Indian Contract Act, 1872
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- ⁶⁸ Section 43 of the Indian Contract Act, 1872
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⁹⁴ Section 64 of the Indian Contract Act, 1872

⁹⁵ Section 65 of the Indian Contract Act, 1872

⁹⁶ Section 66 of the Indian Contract Act, 1872

⁹⁷ Section 67 of the Indian Contract Act, 1872

⁹⁸ "as liability not exclusively referable to any other head of law imposed on a particular person to pay money to another, on the ground of unjust benefit."

⁹⁹ "a situation in which law imposes upon one person, on grounds of natural justice, an obligation similar to that which arises from true contract, although no contract, express or implied, has in fact been entered into by them."

¹⁰⁰ Section 72 of the Contract Act, 1872

¹⁰¹ Section 69 of the Contract Act, 1872

¹⁰² Section 70 of the Contract Act, 1872

¹⁰³ Section 71 of the Contract Act, 1872

¹⁰⁴ Section 68 of the Contract Act, 1872

¹⁰⁵ Section 73 of the Contract Act, 1872

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UNIT 6 INTERNATIONAL CONTRACTS OF SALE

Objectives

After studying this unit you should be able to:

- Explain the meaning and relevance of the Contracts for International Sale of Goods
- Understand the historical background of the Contracts for International Sale of Goods
- Discuss the Applicable Law And Rules for International Sale of Goods
- Describe the different Model Contracts And Clauses Contracts for International Sale of Goods

Structure

- 6.1 Introduction
- 6.2 Historical Background
- 6.3 Applicable Law and Rules
- 6.4 Model Contracts and Clauses
- 6.5 Assessment of Sale of Goods by Transfer of Property with Certainty and Flexibility
- 6.6 CISG Influence on Individual National Systems
- 6.7 Regional Efforts
- 6.8 Covid-19 Pandemic and its Impact on the Performance of International Sale of Goods Contract
- 6.9 Summary
- 6.10 Self Assessment Questions
- 6.11 Further Readings/References

6.1 INTRODUCTION

The Liberalisation, Privatisation and Globalisation (LPG) wiped out the boundaries amongst countries and made the world as a global village. There were different substantive laws relating to contracts in different legal systems which will conflict in legal scenario. It paves the way for thinking of uniform laws comfortable to both the parties from different countries when they enter into contract with flexibility and without bias.

The transactions of sale at the international level are considered to be the backbone of international trade through international contracts. The contracts are regarded as international contracts when the parties to the contract are coming from two different States (Countries).¹ More flexible definitions are possible, such as contracts with “significant connections with more than one State,” ‘involving a choice between the laws of different States’, or ‘affecting the interests of international trade.’² As described in the Hague Principles, one approach to identifying a contract as “commercial” may be where “each party is acting in the

exercise of its trade or profession.” (Hague Principles, Article 1(1)). Another approach is found in the United Nations Convention on Contracts for the International Sale of Goods (CISG), which limits its scope to commercial matters by excluding, for example, consumer contracts, such as those for “goods bought for personal, family or household use” (CISG, Article 2(a)).³

There were two important questions which are vital to be answered when a dispute arises between two parties in an international commercial contract. They are:

- 1) Where the dispute of the parties is to be heard i.e., seat of settlement of dispute?
- 2) What are the law or rules that govern the contract i.e., choice of law by the parties?

Answers to the above questions are to be made by the parties to an international contract where they opted an ‘arbitration Clause’ in their contract with an intention to avoid the litigation in the local legal system and the application of the substantive law of countries to which the parties belonging. International commercial arbitration may be particularly popular because, unlike court proceedings, there is a single nearly comprehensive regime for enforcement of foreign arbitral awards.⁴

6.2 HISTORICAL BACKGROUND

The differences in laws are the by-products of different histories, philosophies and worldviews, uniformity is often difficult to achieve. One of the major challenges faced by an international contract of sale is the diversity of legal systems. The conflict of laws exacerbated world-wide because of the global supply chains and contractual networks which operates across the globe. The 20th century focuses on uniform framework to tackle the situation of the diversified legal system. Before the Second world war *Ernst Rabel* suggested the possibility of uniform sales law to the Institute for the Harmonisation of Private Law. In 1930, the UNIDROIT initiated the project to prepare a law unifying the substantive rules governing international sales contracts under the auspices of the League of Nations. In 1935, the Commission of European Scholars under the leadership of *Rabel* prepared a preliminary Report. Though the Second world war interrupted the work, it was resumed in 1951 in the Hague Conference. In 1964, two conventions namely Uniform Law on the International Sale of Goods (ULIS) and Uniform Law on the Formation of Contracts (ULF) unifying the law of international sale of goods were adopted and came into force in 1972. These are still not widely recognised outside Western Europe as instruments of international harmonisation. The establishment of UN Commission for International Trade Law in 1968 paved the way to draft a new unified sales law. The final draft of the Convention on the International Sale of Goods (CISG) approved by the General Assembly of UN in 1980 and came into operation on 1st January 1988.

The CISG is now supported by number of Conventions like the UN Convention on the Limitation Period in the International Sale of goods, the 1983 Geneva Convention on Agency in the International Sale of Goods, the 2005 Convention on the Use of Electronic communications in International Contracts, the 1983 Uniform Rule on Contract Clauses for an Agreed Sum Due upon Failure of Performance. 94 countries ratified and acceded to the Convention as of 2020. The CISG is the best example of unification of private law till date.

There are no statistics available to prove the success of the CISG in developing international trade. The ratification does not mean the unification of international sales law effectively; it provides the contractual parties with a useful or efficient regulatory framework.

The CISG is based on the principle of party autonomy. The parties are at liberty to adopt or exclude the applicability of the principles laid down thereon in the CISG. The ratifying State may ratify in total or with certain restrictions which creates un-certainty to the fact that the Convention is a unifying law on international sale of goods. This creates gaps in the provisions of the Convention.

In interpretational disputes, the national courts and arbitral tribunals have to take the international character and the uniformity in its application and the observance of good faith in international trade into consideration. The CISG does not specify or state a list what these principles are and, consequently, they have to be deduced from the other provisions of the Convention through a process of analogy. The judge may venture outside the four corners of the CISG and settle the matter in conformity with the applicable law. It is clear that the CISG does not unify the law of international sales in an exhaustive manner but instead operates in a supplementary and symbolic relationship with national law, trade usage, party autonomy and other international instruments of harmonisation.

6.3 APPLICABLE LAW AND RULES

I) Conventions

In some international sale contracts, the law applicable to a contract will be provided for in a Treaty. The United Nations Commission on International Trade Law (UNCITRAL) has created three treaties that provide the applicable rules governing certain contracts.

a) United Nations Convention on Contracts for the International Sale of Goods (CISG):

The United Nations Convention on Contracts for the International Sale of Goods is the most widely adopted treaty providing substantive contract rules.⁵ The CISG's scope is limited to commercial contracts for the cross-border sale of goods⁶ Successful implementation of the CISG requires more countries to adopt it and parties to use it. Courts and arbitral tribunals must interpret the CISG in a uniform manner and not through the lens of domestic laws.⁷

b) The Convention on the Limitation Period in the International Sale of Goods:

The Convention on the Limitation Period in the International Sale of Goods (the "Limitation Convention") is a sister treaty to the CISG. Originally adopted in 1974, it was amended in 1980 in order to operate seamlessly with the CISG.⁸ The Limitation Convention applies to the same types of international sales contracts as the CISG with the same scope of application,⁹ but its substantive provisions deal solely with limitation or prescription, providing a sort of statute of limitations for international sales disputes. The general period of limitation provided in the Limitation Convention is four years.¹⁰

Till date, there are 30 State parties to the Limitation Convention whereas 84 State parties in the CISG's. As is the case with the CISG, parties may opt out of its provisions.¹¹ The rules of uniform interpretation for the Limitation Convention generally mirror those found in the CISG.¹²

c) **United Nations Convention on the Use of Electronic Communications Convention in International Contracts:**

The United Nations Convention on the Use of Electronic Communications in International Contracts¹³ is a much more recent Treaty than the CISG or Limitation Convention. Adopted in 2005, it currently has seven State parties. The purpose of the treaty is to remove any legal obstacles to the use of electronic communications in international contracting, creating certainty for contractual parties that contracts and other communications exchanged electronically are as valid and enforceable as their traditional paper-based equivalents.

The scope of the Electronic Communications Convention is broader than that of the other UNCITRAL Treaties in that it is not limited to sales contracts, although it is still aimed at only commercial contracts. Contractual parties may, of course, opt out of its provisions.¹⁴ Like the Limitation Convention, the rules of uniform interpretation for the Electronic Communications Convention mirror those found in the CISG,¹⁵ making the same general categories of research resources relevant.

II) **National Laws**

Parties may also choose national laws to apply to their international commercial contracts. The party with greater bargaining power may insist on its national laws, or parties may instead choose the law of a third State, usually one considered to have a well-developed law with regards to commercial transactions.

English law is frequently used in international transactions, in particular with reference to reinsurance, charter parties, and sea trade, among other areas.¹⁶ Parties may select *Swiss law* because of the perception that Switzerland's political neutrality makes this a neutral law. Nonetheless, political neutrality may not always be the best guide as to the suitability of a chosen law for a specific transaction.¹⁷ The ICC International Court of Arbitration 2013 Statistical Report mirrors the 2010¹⁸ survey and also indicates frequent choice of *German* and *French law*.¹⁹ When considering these types of surveys, it is important to recall that, generally, the choice of law of any CISG State will also include the CISG unless the Convention's application is clearly excluded by the parties.²⁰

Soft Law and Trade Usages

There are many international texts and standards that may be chosen by traders to govern their contracts. These rules may be referred to variably as "rules of law," "soft law" or "trade usages,"²¹ but they are connected by their use in international contracting and potential direct application by arbitral tribunals. Even otherwise binding texts, such as the CISG, may fall into this category when chosen by parties to apply to their contracts without reference to a specific State law²². Like arbitral tribunals²³, State courts may recognize and apply these rules, but, depending on the relevant domestic law, they may do so simply as a set of rules that are considered to be part of the contract and not overriding any

mandatory law.²⁴ The Hague Principles, where followed, may serve to further legitimize some of these sources. The Hague Principles, in Article 3, allow for the law chosen by contracting parties to be “rules of law that are generally accepted on an international, supranational or regional level as a neutral and balanced set of rules, unless the law of the forum provides otherwise,” specifically naming the CISG, the UNIDROIT Principles, and the Principles of European Contract Law (PECL) in the accompanying commentary. A few of the more prominent texts and standards generally discussed in this category of “rules of law,” “soft law” or “trade usages” are as follows:

UNIDROIT Principles

The UNIDROIT Principles of International Commercial Contracts (the “UNIDROIT Principles”) were first finalized by UNIDROIT in 1994 and revised in 2004 and 2010. UNIDROIT continues to revise the Principles as appropriate, currently considering revisions meant to deal with specific aspects of long-term contracts. While following the CISG’s approach in many instances, the UNIDROIT Principles are a set of general rules for international commercial , addition, they are able to cover areas that the drafters of the CISG were not able to agree upon, such as validity, agency, and assignment, among others. Also unlike the CISG, the UNIDROIT Principles are not a binding text and will generally only be applied where chosen by the parties or through application by an arbitral tribunal with the authority to do so.²⁵

Significantly, the UNIDROIT Principles contain rules of interpretation almost identical to CISG,²⁶ making case law and academic writings of great use in interpreting the Principles. In addition, the UNIDROIT Principles have a built-in commentary that gives detailed guidance.

The advantage of Principles of International Commercial Contracts (PICC) is that they do not favour one particular domestic system of contract law or even legal system but rather provide a neutral set of rules that combine the best practices from legal systems around the world. The UNCITRAL on its’ endorsement of the 2010 PICC stated that these Principles and the CISG principles are complementary relationship and that PICC can be used to interpret and supplement the convention.²⁷ The 2015 *Hague principles on choice of law in International Commercial Contracts*, which were adopted by the Hague Conference on Private International Law might trigger welcome change.²⁸ Continuously improved since their first inception in 1983, the PICC have been described as a ‘restatement of international contract law’²⁹ The PICC could function as a new *lex mercatoria*.

Lex mercatoria

The *lex mercatoria* has been described as “a synthesis of generally held and generally accepted commercial principles that may be expected to be applied to contracts among the major trading nations.”³⁰ There is a controversy³¹ surrounding the *lex mercatoria* and, in particular, the specifics of its content,³² but arbitral tribunals can, nonetheless, where authorized, apply these principles.³³ Certainly, the content of the *lex mercatoria* may be informed by or, in fact, contain the content of international instruments, such as the CISG and the UNIDROIT Principles.³⁴ For an example of a contract clause containing choice of such broad principles, consider the United Nations General Conditions of Contract, which state, with regard to dispute settlement, that “the decisions of the arbitral tribunal shall be based on general principles of international commercial law.”³⁵

Incoterms

In the specific area of delivery of goods, the International Chamber of Commerce (ICC) has developed a set of rules governing trade terms that describe the obligations of buyers and sellers and supplement any other rules governing the contract. The terms are in combination of three letters. One example is FOB, standing for “Free on Board”, and the Incoterms rules cover who bears the risks and obligations when the seller has contracted to deliver goods in this way, namely “on board the vessel nominated by the buyer at the named port of shipment or procures the goods already so delivered.”³⁶ The Incoterms come with instructions as to how parties can incorporate them in their contracts. There have been many versions of the rules, and the most recent are the Incoterms 2010 and 2020. They were first published in 1936. Incoterms 2010 defines 11 rules. They are upgraded as per the trade practices.

The Uniform Customs and Practice for Documentary Credits (UCP 600)

This was another creation of International Chamber of Commerce for the convenience of international trade. The Uniform Customs and Practice for Documentary Credits, 2007 revision UCP 600, is the soft-law instrument for regulating letters of credit, a common payment method in international transactions. The contract must indicate the application of UCP 600 towards the credit document. It contains rules specifically for electronic records.

6.4 MODEL CONTRACTS AND CLAUSES

International contracts refer to a legally binding agreement between parties, based on different countries, in which they are obligated to do or not to do certain things. International contracts may be written in a formal way. Most businesses create contracts in writing to make the terms of agreement clear, often seeking legal counsel when drafting important contracts. Contracts can cover all aspects of international trade, although the most commonly used are:

- International Sale Contract
- International Distribution Contract
- International Agency Contract
- International Sales Representative Contract
- International Supply Contract
- International Manufacturing Contract
- International Service Contract
- International Strategic Alliance Contract
- International Joint Contract
- International Franchise Contract

Model contracts are particularly useful for preparing international business transactions, but they are often expensive. The International Trade Centre offers for free online its Model Contracts for Small Firms and Legal Guidance for Doing International Business. The ICC offers (for purchase) an array of model contracts for international transactions, including an influential model for sales contracts.

The contracts are the products of some of the finest legal minds in the field of international commercial law. They are constructed to protect the interests of all

the parties, combining a single framework of rules with flexible provisions allowing the parties to insert their own requirements.

Arbitration institutions and rules typically offer model clauses that can be useful for incorporating an **arbitration clause** in a contract. For example, the model clauses of the Arbitration Institute of the Stockholm Chamber of Commerce, the LCIA, and the International Centre for Dispute Resolution.

Choice of law clauses can be found in the model contracts mentioned above, but there are also other sources. UNIDROIT, for example, has prepared Model Clauses for the use of the UNIDROIT Principles of International Commercial Contracts. Some arbitration institutions also offer model choice of law clauses. For example, the clauses from the Chinese European Arbitration Centre.

The ICC *Confidentiality Agreement* is the latest in a series of widely used model contracts published by the International Chamber of Commerce.

The ICC *Force Majeure Clause 2003* and the ICC *Hardship Clause 2003* are the examples of the model readymade clauses to be inserted by the parties in their International Commercial contract.

6.5 ASSESSMENT OF SALE OF GOODS BY TRANSFER OF PROPERTY WITH CERTAINTY AND FLEXIBILITY

The transfer of property takes place when the contract is concluded even the delivery and payment of price happens subsequently. This principle was adopted by French law by Code Civil of 1804. The same appears in English rule set out in Sale of Goods Act (SOGA), 1893. The other system of transfer of property is stipulated by the delivery which was seen in German Law and Australian Law; the former talks of abstract delivery and the latter with casual delivery. The transfer of property i.e., the ownership belongs to the realm of general formulas, while the solutions of the various practical problems belong to the realm of operational rules. Thus, it is observed that even legal systems with contrasting general formulas can share identical operational rules.

When questions emerge from the perspective of the ownership, the judge must refer to the domestic law applicable according to the usual rules of conflict. The absence of precise rule in the CISG is not a loophole; it was a deliberate choice by the drafters to leave it the judge to decide as it was a highly sensitive aspect in the sale of goods. This facilitated the adoption of CISG by divergent legal systems that adopt one solution or the other for domestic sales.

A certain degree of certainty is attributed to the sale laws that guarantee the maximum predictability of the solutions asked by the judges and arbitrators. This implies that legal rule must be as precise as possible and must avoid loopholes, generic directive for the parties or interpretation gapes for the decision of cases. On the other hand, any sale law that contains general clauses, such as the good faith principle, binding the contracting parties to behaviour, whose legitimacy is decided after the event by Judge or arbitrator, is considered flexible. In particular, the English law considered a bulwark of certainty, and German law is considered as very flexible. The former does not have an obligation to act in

good faith, while the latter, good faith and reasonableness permeate the entire spectrum of contract relationships. The tension between certainty and fairness is solved by the CISG principles.

6.6 CISG INFLUENCE ON INDIVIDUAL NATIONAL SYSTEMS

It was noted by the scholars that CISG is having impact regarding both sales of goods, obligations law and contractual law generally on the numerous legal systems.³⁷ Its' influence on individual legal systems may be felt by the courts, by doctrine, by legal practice and law-makers. The Dutch judges used the CISG principles in interpreting the national law regarding the formation of contract, breach of contract and non-conformity of goods sold.

The Scandinavian countries except Denmark revised their national Sale of Goods Acts in line with the most of the principles of CISG: Finland in 1988, Norway in 1989, Sweden in 1991, and Iceland in 2000.

The CISG influenced the Europe by the Law of Obligations Act in 2002 which is the identical transposed binding's nature of usages and practices, the objective interpretation of the declaration of intent, the freedom of form, the mitigation of harm and the prohibition of abuse of rights³⁸. The Tokelu Islands has adopted the rules of the CISG as domestic law both for the sale of goods and for general contract law. The largest economy, China, the CISG has essentially become part of domestic law. The Contract Law 1999 was amply supported by CISG rules. The drafters of new Chinese Civil code were able to find in the CISG a very important resource of rules both for the sale of goods and the contract law in general.

In some legal systems reforms in the national laws have begun or have been suggested. New Zealand Sale of Goods Act, 1908 is the example of this reform. The largest economy in Africa, Nigeria though not ratified the CISG; Nigerian Law Reform Commission began to consider a reform of the Sale of Goods Act, 1893³⁹. It reproduces the old English law on sale of goods and now there is a call for the reform to take the CISG as model law⁴⁰.

Japan didn't ratify the CISG for a long period. The scholars noted that CISG rules are arguably better than the Japanese sales law⁴¹. The on-going reform⁴² of the Japanese law of obligation could raise the level of reception of CISG principles and rules in the Japanese legal system. The Turkey new Code of Obligations deeply reformed the contract law which was, based on the Swiss model adopted in 1920⁴³.

Seventeen central African countries who are currently the members of the Organization for the Harmonization of business law in Africa (OHADA) intended to remedy the legal and juridical uncertainty that exists among the signatory states. In 1997 they adopted a uniform law governing commercial law which was modified and modernised in 2010. This regulates all the sales of goods between companies, and excludes the sales to consumers. With French culture they adopted the CISG principles to domestic sale of goods, including several rules deriving from English Common Law.

6.7 REGIONAL EFFORTS

The preamble to CISG states that: The adaptation of uniform rules which govern contracts for the international sale of goods and take into account the different social, economic, and legal systems would contribute to the removal of legal barriers in international trade and promote the development of international trade.

The European Commission proposed a new uniform law on the sale of goods, intending to solve the problems arising from this diversity of national contract laws. The Common European Sales law (CESL) governs sales to both consumers and businesses. The CESL would then offer a new choice between the legal systems that the parties can make freely; any national law either of EU members or of other states.

The Association of Southeast Asian Nations (ASEAN) approved the ASEAN Trade in Goods Agreement. These treaties expand the free trade area beyond the borders of the community of ASEAN countries, and envisage the gradual implementation of the free circulation of goods between ratifying state, elimination of customs and protectionist barriers. However, these treaties do not contain rule to be applied to the international trade contracts, but are limited to encouraging strong regional standardisation.

The UNCITRAL and The Hague have recently established regional centres that offer a significant opportunity to promote the various private international law instruments, including those relating to international contract law.⁴⁴ In the light of the importance of the issue, efforts by the UNCITRAL Secretariat are welcome to explore other means of promoting and maintaining uniformity in the interpretation of the CISG. The Secretariat recently proposed the establishment of a system of national centres of expertise in the field of commercial law that go beyond the current national correspondent system of Case Law on Uncitral Texts (CLOUT).

According to the Secretariat, the system would

- a) Collect, analyse, and monitor national case law related to UNCITRAL texts
- b) Report the findings to UNCITRAL, and
- c) Address the need of the judiciary to better understand the internationally prevailing application and interpretation of UNCITRAL standards and achieve effective cross-border co-operation.⁴⁵

Resources are the biggest obstacle to such a proposal as noted by the Secretariat.

Cooperation:

The UNCITRAL and its sibling operations, UNIDROIT and the Hague Conference should continue to coordinate and cooperate on all matters regarding the international contract law in order to ensure that the organisations' agendas remain complimentary. The UNIDROIT and UNCITRAL have recently supported consideration of joint collaboration between the two organisations on substantive law projects as suggested by US⁴⁶. These two may consider a joint project on long-term contracts.

Naturally evolving harmonisation through progressive interpretation and the use of existing instruments will continue to ensure that harmonisation is workable

and feasible. The CISG and PICC working together, have been remarkably successful in addressing the needs of commercial players in international commerce. There are more practical, positive and forward-looking alternative that build on the existing platform of the CISG and the PICC. The UNCITRAL must continue its efforts to assist States in maintaining uniform interpretation and implementation of the CISG.

Battle of forms:

Battle of the forms is one of the unresolved legal problems to which different countries' courts have their own approach. There are three main approaches in the literature as to the battle of forms; domestic approach, last shot rule and knock-out rule. The last shot rule and knock-out rule are in competition with each other. The courts are required to answer two questions; **a.** Is there a valid contract between the parties? **b.** If yes, which terms of the standard forms are the parts of the contract? The CISG has not given uniform answers to solve the arisen disputes.⁴⁷ The battle of forms dilemma can't be resolved by single formula as there are different situations of collusion and the various positive behaviours of the parties.

The CISG is not concerned with validity of contract. Which standard terms should be incorporated into the contract shall be solved by the applicable domestic law.⁴⁸ The courts are required to look to the general principles of the CISG first, before recourse to domestic law. Domestic approach is not widespread as this is inconsistent with the main reason with the existence of CISG, namely unification of the sales law.

A reply to an offer which purports to be an acceptance but contains additions, limitations or other modifications is a rejection of the offer and constitutes a counter-offer. The traditional common law rule namely the 'mirror image' rule, which produces the last shot rule in order to answer to the battle of forms issue. The last shot rule 'treats every statement made with reference to confliction standard terms as a rejection of the earlier offer, combined with counteroffer.⁴⁹ In other words, the contract is concluded on the terms of the final form used, without being objected by the other party.⁵⁰ The conflicting standard terms knock each other out and the provisions of CISG are applied instead of them. The courts are to find the actual or deemed consensus of the parties based on their negotiations in respect of the essential elements of transaction.

The aforesaid analysis of the battle of the forms makes it clear that knock-out rule is supported by scholars and cases, because of advantages such as conformity with the intention of the parties to the business, balanced and fair approach, supportive approach to the contract validity issue, and providing uniform application of the Convention by referring to its provisions in case of knock –out terms.

6.8 COVID-19 PANDEMIC AND ITS IMPACT ON THE PERFORMANCE OF INTERNATIONAL SALE OF GOODS CONTRACT

A *force majeure* clause in international sale of goods contract relieves a party from performing its contractual obligations when certain circumstance beyond its control arise, making performance inadvisable, commercially impracticable, illegal or impossible.

The CISG Article 79 provides that “(a) Party is not liable for a failure to perform any of his obligations if he proves that the failure was due to an impediment beyond his control and that he could not reasonably be expected to have taken impediment into account at the time of conclusion of the contract or to have avoided or overcome it, or its consequences”

The treatment of impediment under CISG is different from the treatment under common law. Generally, four conditions must be satisfied to assert the *force majeure* protection under the CISG:

- 1) The impediment must be *beyond the party's control*
- 2) The impediment is *unforeseeable* at the time the contract was signed.
- 3) The impediment and its consequences could not be reasonably *avoided or overcome*.
- 4) The *non-performance* of the party is the result of the impediment.

Under Article 2 of the Uniform Commercial Code (UCC) of US a seller may be excused from delay or non-delivery of the goods if performance has been made *impracticable* by either:

- 1) The occurrence of an event “*The non occurrence of the which was a basic assumption on which contract was made*” or
- 2) Good faith *compliance* with *foreign or domestic government regulation*

The Common law doctrines of frustration and impossibility may be invoked, but they have higher threshold to overcome.

Predating the Covid-19 pandemic, well known examples such contractual arrangements are found in model clauses issued by International Chamber of Commerce (ICC), namely ICC's 2003 *force majeure* clause, and the ICC's Hardship clause. This has changed with the ICC's 2020 Hardship clause which suggest three different legal consequences in the event of failed renegotiations, any of which the parties can choose when concluding the contract;

- 1) The termination of the contract by one of the parties,
- 2) The termination of the contract by a Judge (or Arbitrator) or
- 3) finally, the adjustment or termination of the contract by a Judge (or Arbitrator)

To combat uncertainties for future crises like COVID-19, it is therefore advisable to negotiate individual contractual clauses pertaining to *force majeure* and hardship in order to determine the desired distribution of contractual risk in advance⁵¹.

6.9 SUMMARY

In business-to-business international transactions, it would appear that the market is operating affectively on that differences in contract law do not pose a serious obstacle to cross-border trade. The conventions, the national laws, soft laws and trade usages, Unidriot principles, *lex Mercatoria*, incoterms, UCP 600, model contracts and clauses, CISG, PICC, Uncitral principles will help to overcome the obstacles faced by the parties in their cross-border trade through international contracts of sale of goods.

6.10 SELF ASSESSMENT QUESTIONS

- 1) Explain the importance and significance of international contracts.
- 2) Discuss in detail the law and rules applicable to international contracts
- 3) Write a note on the historical back ground of the international sale of goods contracts.
- 4) Analyse the assessment of sale of goods by transfer of property with certainty and flexibility.
- 5) Make a brief note on CISG influence on individual national systems
- 6) Elucidate the regional efforts and cooperation in unifying the sales law.
- 7) Critically evaluate the methods of battle of forms.
- 8) Discuss the unforeseen circumstances which resulted the non-performance by a seller in an international contract of sale.

6.11 FURTHER READINGS

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- 3) Kamal Huseynli, different Approaches to conflicting Standard Terms under the United Nations Convention on Contracts for the International Sale of Goods, *BAKU State University Law Review*, vol.2. Issue 2, May 2016 p.197
- 4) J Cotzee, A Pluralist Approach to the Law of International Sales, *PER/PELJ* 2017(20) p.1
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- ¹ see United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980) (the “CISG”), Article 1(1); Principles on Choice of Law in International Commercial Contracts (2015) (the “Hague Principles”), Article 1(2)).
- ² Preamble Comment UNIDROIT Principles of International Commercial Contracts 2010
- ³ Cyril Emery, International Commercial Contracts, Published in March 2016
- ⁴ governed by the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958) (the “New York Convention”) with 156 State parties
- ⁵ (Vienna, 1980, the “CISG”)
- ⁶ see CISG, Part I, Articles 1-5
- ⁷ Renaud Sorieul et al., *Possible Future Work by UNCITRAL in the Field of Contract Law: Preliminary Thoughts from the Secretariat*, 58 VILL. L. REV. 491, 500 at n.25 (2013) (citing John O. Honnold, *The Sales Convention in Action—Uniform International Words: Uniform Application?*, 8 J.L. & COM. 207, 208 (1988)).
- ⁸ References in this text are to the amended Convention unless stated otherwise.
- ⁹ see Limitation Convention, Articles 1-6
- ¹⁰ Limitation Convention, Article 8
- ¹¹ Limitation Convention, Article 3(2)
- ¹² Limitation Convention, Article 7
- ¹³ New York, 2005-the “Electronic Communications Convention”
- ¹⁴ Electronic Communications Convention, Article 3
- ¹⁵ Ibid, Article 5.
- ¹⁶ See, e.g., GIUDITTA CORDERO-MOSS, INTERNATIONAL COMMERCIAL CONTRACTS: APPLICABLE SOURCES AND ENFORCEABILITY 137 (2014); Gerhard Dannemann, *Common Law-Based Contracts under German Law, in BOILERPLATE CLAUSES, INTERNATIONAL COMMERCIAL CONTRACTS AND THE APPLICABLE LAW* 62, 63 (Giuditta Cordero-Moss ed., 2011).
- ¹⁷ Ingeborg Schwenzer & Christopher Kee, *International Sales Law – The Actual Practice*, 29 PENN ST. INT’L L. REV. 425, 440-441 (2011).
- ¹⁸ 2010International Arbitration Survey:Choices in International Arbitration
- ¹⁹ 2013 Statistical Report, 25 ICC INT’L CT. OF ARB. BULL., no.1, 2014 at 5, 13.
- ²⁰ A few States have made declarations under CISG, Article 95, including the United States, indicating that they will not be bound by Article 1(1)(b). With regard to choice of law, it should be noted that courts and arbitration tribunals have generally found that, for the purposes of considering which law should apply when parties have generically chosen the law of a CISG State, the CISG forms part of the law of that State and will apply unless the parties have excluded its application or have specifically referred to the domestic law of the State, for example, by identifying the particular code in

question. UNCITRAL DIGEST OF CASE LAW ON THE UNITED NATIONS CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS Art. 6, paras. 9-17 (2012).

- ²¹ See, e.g., CORDERO-MOSS, *supra* note 16, at 31.
- ²² see section 3.1.1
- ²³ see section 2.2
- ²⁴ Consider, for example, the UCP 600 (see section 3.3.4). While very widely used and applied, State courts have, in some instances, overridden the UCP 600 with State law despite party choice to be governed by its provisions. CORDERO-MOSS, *supra* note 16, at 64-68.
- ²⁵ MODEL CLAUSES FOR THE USE OF THE UNIDROIT PRINCIPLES OF INTERNATIONAL COMMERCIAL CONTRACTS 4-6 (2013).
- ²⁶, Article 7, (UNIDROIT Principles, Article 1.6)
- ²⁷ Report of the United Nations Commission on International Trade Law, 45th Session UN Doc A/67/17 (2012)
- ²⁸ These principles were endorsed by UNCITRAL at its 48th session. Report of the *United Nations Commission on International Trade Law*, 48th Session UN Doc/A70/17(2015)
- ²⁹ Michael Joachim Bonell “The Law governing International Commercial Contracts: Hard law Versus Soft law” in collected courses of the Hague Academy of International law (Brill Leiden-2018) vol 388
- ³⁰ WILLIAM F. FOX, INTERNATIONAL COMMERCIAL AGREEMENTS AND ELECTRONIC COMMERCE 31 (5th rev. ed. 2013).
- ³¹ Regarding the customary, trade practice and normative understanding of contractual terms in the international sales contracts with regard to dispute between the parties to an international sales contract.
- ³² INGEBORG SCHWENZER ET AL., GLOBAL SALES AND CONTRACT LAW (3d ed. 2012) at 49-50
- ³³ *ibid*
- ³⁴ See, e.g., Alexis Mourre, *Applications of the Vienna International Sales Convention in Arbitration*, 17 ICC INT’L CT. OF ARB. BULL., no.1, 2006 at 43, 49; SCHWENZER, *supra* note 27, at 49-50.
- ³⁵ The term that was used in an international sales contract keep in view the meaning of the term as per customary, trade practice or normative understanding of the said term.
- ³⁶ INCOTERMS 2010: ICC RULES FOR THE USE OF DOMESTIC AND INTERNATIONAL TRADE TERMS 87 (2010).
- ³⁷ Cf Franco Ferrari, ed, *The CISG and its Impact on National Legal Systems* (Munich: Sellier European Publishers 2008); Peter Schlechtriem, “Basic Structures and General Concepts of the CISG as models for harmonisation of Law Obligations” (2005) 10 *Juridica Int’l*. 27
- ³⁸ Cf Irene Krull, “Reform of Contract Law in Estonia: Influences of Harmonisation of European Private Law” (2008) 14 *Juridica Int’l* 11 22.
- ³⁹ At a workshop on 2nd September 2014, the Nigerian Law Reform Commission began to consider a reform of the Sale of Goods Act, 1893 though CISG was not ratified by Nigeria.

- 40 Cf Nkiruka Maduekwe, “The CISG and Nigeria: is there a Meeting Point” (2009/10) 14 CEPMLP Ann. Rev., online.
- 41 Cf Noboru Kashiwagi, “Accession by Japan to Vienna Sales Convention (CISG)” (2008) 25 J Japan L 207 at page 214.
- 42 Ibid.
- 43 The New Code (Article 208) follows the solution of the CISG (arts. 67, 68) regarding risk of accidental destruction and deterioration of the goods sold. The old code connected the passage of risk with the conclusion of the contract where as risk and benefit on the goods sold in the new code pass to the buyer at the moment of the transfer of possession.
- 44 See UN Information Service, New UNCITRAL Regional Center for Asia and the Pacific opens Republic of Korea, Press release UNIS/L/159(26 January 2012); see Hague Permanent Bureau, Report on the Activities of the New Regional Offices of Latin America and the Pacific, Doc Information no 1(March 2013)
See Unicitral Secretariate, Technical Cooperation And Assistance Un Doc A/CN.9/775(May2013) Para 11.
- 45 See Renaud Sorieul, Emma Hatcher and Cyril Emery, “Possible Future work by UNICITRAL in the field of Contract Law: Preliminary Thoughts from the Secretariat” 58 VillanovaLaw Review 491, 505
- 46 US proposal on *UNCITRAL Future Work* (n 10) 4-5; UNIDROIT Governing Council, 92nd Session (n 133) para 35.
- 47 See Larry A. Dimatteo et.al., The interpretive turn in International Sales law: An Analysis of Fifteen years of CISG Jurisprudence, 24Nw.J.Intl & Bus.299, pp.349-357(2004)
- 48 Francois Vergne, The “Battle of the Forms” Under the United Nations convention on Contracts for the International Sale of Goods, 33 Am.J. Comp. L 233 pp.256-257(1985)
- 49 Andre Corterier, A Peace Plan for the Battle of the Forms, 10 Int’l Trade & Bus.L.Rev.195 p .197 (2006)
- 50 Peter Huber, Standard Terms under the CISG, 13 Vinodnona Journal of International Commercial law & Arbitration 123, p.129(2009)
- 51 Andre Janssen and Christian Johannes Wahnschaffe, COVID-19 and international sale contracts: unprecedented grounds for exemptions are business as usual? Uniform Law Review, 2021 February 2, published online 2021 Feb 2. doi: 10.1093/ulr/unaa026.

BLOCK-4

LEGAL AND REGULATORY FRAMEWORK FOR FINANCING AND INVESTMENTS OF BUSINESS

Unit 7 Banking and Other Allied Regulations

Unit 8 Foreign Exchange Management and Related Regulations

Unit 9 Insolvency and Bankruptcy



UNIT 7 **BANKING AND OTHER ALLIED REGULATIONS**

Objectives

After studying this unit you should be able to:

- Understand the evolution of Banking Regulation
- Explain the terms and conditions to be complied with for obtaining a bank license.
- Discuss the interface of Banking Regulation Act with other laws
- Describe the role of Central Government in regulating the banking sector in India

Structure

- 7.1 Introduction
- 7.2 Evolution of Banking Regulation
- 7.3 Regulation in relation to Chartering / Licensing
- 7.4 Regulation in relation to the Bank Management
- 7.5 Regulations with respect to ensuring Liquidity and Healthy Lending Practices
- 7.6 Reporting Requirements, Inspections, and Audit
- 7.7 Penal Powers
- 7.8 Summary
- 7.9 Self Assessment Questions
- 7.10 Further Readings

7.1 INTRODUCTION

Regulation of financial sector is extremely important. But within the sector, banking sector regulation is most important. The reason has to do with the importance of the role it plays in the economy, the fragile nature of the business model of the banks and the consequences of bank failures, as has been observed in most serious recessionary phases in recent history, including Great Recession of 2008.

Banks not only serve as depository of people's savings, but also serve as a payment mechanism. The payment system, which majorly runs on payment orders made to and cheques drawn by us on our banks, runs on the assumption that the amount standing to our credit in the account is as good as real money. The agreement between two parties to do an impossible act itself is void. A contract may also void because of an event which makes the performance of promise impossible or unlawful after the completion of the contract. The amount shown in our account as credit is a mere debt due to us from the bank which is repayable on our demand. Our confidence that it would be so paid whenever asked for, and the ability of banks in almost all instances to do so ensures that we treat it as good as money. But we tend to forget that the bank lends this money, and to cover for its cost of

operations and the interest paid to us, it has to lend it at a higher interest rate which would usually be for a fixed duration. Thus, we come to a situation where the bank has liabilities which are short term in nature, and assets which are long term. This mismatch between the time frame of assets and liabilities is what underlies the fragility of the banking business. The business not only has to manage the liquidity, but also ensure that the depositors retain confidence in the bank, so that not only fresh funds keep coming in to match the payment orders and instructions, but also that the depositors do not lose confidence in the bank as the loss of confidence would certainly would cause a run on the bank causing it to fail.

A bank failure has an effect on all segments of the economy. The depositors not only lose their liquid assets, but may even be the cause of failure of businesses which used the failed bank for receiving and making payments, for providing bank guarantees or which had an overdraft facility on the back of the security given by them. This would now not be released any time soon till the bank insolvency process is completed. This may even have a systemic effect, if the entity is large. A bank failure may lead to a panic reaction amongst the general mass of depositors, leading them to withdraw deposits from other banks, causing a bank run. Healthy banks would fail if suddenly there is a run on their deposits. Depositors and businesses dependent upon them fail and soon enough an isolated instance of bank failure balloons into a system wide series of failures as was experienced during the Great Depression of 1929 and Great Recession of 2008. The failures also affect the money supply floating in the economy, as the banking system multiplies the money. The money in circulation due to the operation of the banking system is usually a few multiples of the base money (the printed money or the issued coins).

7.2 EVOLUTION OF BANKING REGULATION

After understanding the importance of banks in the economy and the necessity of regulating them, more than other players in the economy, the question arises as to who is best placed to regulate the banks and the legal basis of the regulatory power.

The first necessity for bank regulation came by the need for cooperation amongst the banks in executing payment instructions and making collections on the cheques deposited with them. Instead of chasing each bank individually, it was thought fit to have a central place where the banks of a local area could meet and instead of paying each cheque individually to another bank for the other bank's customers, only the net balance due to each bank be paid. So, local areas had a clearing houses. Since cheques honoured in the interim may bounce, either due to insufficiency of funds or signature of the purported cheque writer not matching, the collecting bank had to be solvent enough for return of moneys in such cases. Clearing house membership was an informal regulation of the industry as it was dependent upon confidence in the solvency of the banks who met. But the role of industry specific bodies in forming standards for the guidance of its members has over a period of time has become more formal, and recognized by courts in determination of industry standards for service.

The fragility of the banking system meant that whenever there was a run on the banks, howsoever well run and solvent they might be individually, howsoever

good their asset quality be, there would always be a chance that they might fail. No other financier would be willing to lend to the bank because it would be afraid that even if the money lent is not lost, it may not be available to it in times of crisis. So, a need was felt for a lender of last resort in times of crisis – an entity willing to lend when no one is willing to do so because they are dependent on demand deposits to lend. The entity should not depend on retail deposits and have the power to create the money which is accepted as a valid tender.

In the late nineteenth century, Bank of England emerged as a lender of last resort to the English banks. In the first decade of the twentieth century, the Federal Reserve Board was formed to be the lender of last resort in the United States of America. During the Great Depression a need was felt to have a lender of last resort. In pursuance of this strongly felt need, the Reserve Bank of India (RBI) was formed in 1934. Basically, the structure followed was that the banks which wanted to be eligible to be considered for lending by the RBI, had to maintain a certain percentage of their deposits with such lender of last resort (central bank) and had to observe prudent business practices to be considered for lending in emergency situations. It is like a bank exercising some control and surveillance over a borrower who has been given an overdraft facility. With banks having deposits with the RBI, it also has a role in the clearing house operations, thus giving it a bird's eye view of the working of the financial system and the solvency of the individual players.

Regulation by perceptions of solvency and contract were thought to be insufficient. Regulatory power was not statutory, as though the entities like Bank of England or RBI may have come into existence either by charter or statute, the shareholders were private individuals. After the nationalization of Bank of England and the Reserve Bank of India, regulatory powers were given to the central bank, in the same way as they could be exercised by the said executive wing of the government. The powers have been reserved with the executive wing of the government in some countries. But it was thought appropriate to give it to an entity which has expertise in the sector, which would anyway perform a regulatory role with regard to most of the banks because of it being the lender of last resort and thus avoid duplication of effort. In this way, Banking Regulation Act, 1949, gave the Reserve Bank of India the statutory regulatory power over most of the banks. The government retained for itself the role of giving directions where it found appropriate, and being a forum for appeal for most decisions taken by the RBI.

While RBI has the primary role in regulation of banks, it shares the regulatory space with certain other bodies. In the case of agricultural cooperative banks and regional rural banks, National Bank for Agriculture and Rural Development (NABARD) also has a regulatory role as it is the principle refinancing body for these banks serving specific needs of a sector of the economy. In the case of urban cooperative banks, the principle means by which the RBI used to regulate was by being the lender of the last resort for the banks which were in the second schedule of the RBI Act. Recently, by amendment to the Banking Regulation Act, RBI has been given a primary regulatory role over these banks, almost at par with what it has in the case of commercial banks. However, it ought to be noted that cooperatives having been organized under the state statutes relating to cooperatives, the registrar of cooperatives of the state of incorporation will also have a regulatory role (not so in the case of multi state cooperatives). In the case of public sector banks, the regulatory role of the RBI is dependent upon how much of the regulatory powers relating to them is ceded by the Central

Government to the RBI under the Banking Regulation Act (BRA). At present, Central Government has given the RBI almost all the powers over the public sector banks which the RBI has over the private commercial banks, with the exception of the powers over the Board and other Officers of the bank.

We have considered the regulation by industry standards setting bodies, contractual arrangements for deriving of benefits, either as lender of last resort or refinancing arrangements or deposit insurance etc., and by statute. Another source of regulation is the soft law framed by different international associations for regulators for the guidance of the member regulatory bodies. As far as banking is concerned two transnational bodies are important. The first is Bank of International Settlements, Basel, and the Financial Action Task Force.

Bank for International Settlements (BIS) was originally a small body of central banks of developed economies, but its membership has recently expanded. The bank has as its primary remit the stability of the international financial system. After the Herstatt crisis in the mid 1970s, when the failure of a German bank created problems for the payment system in New York, BIS has sought to address the issue of how to ensure that the banks which are participants in the international payments systems and mechanisms, stay solvent to honour their commitments. Towards this end, with the sanction of the member central banks it has periodically made rules for calculation of the capital required by a bank for doing business. Though the rules are meant only for the banks engaged in cross border payments and which belong to the member states, requirements of international trade and international payment system operation almost made it incumbent to most central banks to frame regulations based on the BIS guidelines. International trade depends upon letters of credit and banks must have confidence in the letter of credit opened by its counter party in another country to agree to become the payer on being presented the documents by the exporter. In a similar manner, the guidelines of the Financial Action Task Force (FATF), formed for the purpose of curbing the use of the financial system for money laundering, are adopted by not just the member countries but all others who want their financial institutions not to be excluded from the international financial system.

One has to remember that regulatory bodies acquire expertise in certain sectors of the economy. The legislature may want to use the expertise developed by these bodies for regulating the allied sectors. Sometimes it is necessary, as carrying out the responsibilities in one area may require an input from or a corresponding action in another arena of economic activity. Inactivity in the allied area may lead to the players exercising what many would call the regulatory arbitrage - taking advantage of the absence of rules in the allied sector to carry on the same activity without checks and balances. Banks and non banking finance companies (NBFCs) are different. The deposits of the latter are not repayable on demand and they don't act as the agent of their customers in the payment system and so don't form part of the payment system. But a very short term deposit or commercial paper (as in the case of Lehman Bros which failed in 2008) may make them also very fragile. If the lenders to these institutions are banks, then the regulator for banks becomes interested in their solvency, more so if the banks form these NBFCs to bypass the regulatory barriers. That is why they are sometimes called shadow banks. As a result of this, the RBI was given the regulatory remit for the NBFC sector by an amendment to the RBI Act in 1997, when a regulatory vacuum in the NBFC sector was noticed after the failure of

many depository NBFCs. Similarly, since the RBI has the remit to maintain the monetary stability (stability in the value of the currency), it has the regulatory powers in the money market (short duration loan and short term debenture market) under the RBI Act, monetary payment and settlement systems (under Payment and Settlement Systems Act) and regulates the capital flows in the foreign exchange market (under Foreign Exchange Management Act).

7.3 REGULATION IN RELATION TO CHARTERING / LICENSING

Banking is a business of borrowing and lending money, but with special features which are absent in other borrowing and lending businesses. Not only are deposits with it repayable on demand, but they are repayable only in the branch with which the account is kept, and the bank also gives the cheque facility to its customers and would collect cheques on their behalf. The last requirement means that the bank has to take a debt/deposit from its customer and whenever the customer wants it the bank cannot refuse it as in case of ordinary debtors.

Banking Regulation Act prevents any person or entity to give a cheque writing facility to its customers if the person or entity is not a bank. Further it prevents the use of the term bank by any entity which is not a banking company registered under the Banking Regulation Act (though some entities use the terminology under the special statutes by which they are created or under which they are incorporated). While banks were in business long before BRA came to be enacted, a time frame was given for such banks to get the license to operate as a bank from the RBI. All new banks to operate as a bank needed a license from the RBI. The grant of a license is the discretion of the RBI, but the BRA lays down certain conditions for the exercise of its discretion, conditions which it is required to be satisfied about before grant of a license. The company must not only be in a position to repay present and future depositors in full as their claims accrue, but should have adequate capital structure and earning prospects along with the character of the proposed management and the conduct of its affairs not being opposed to public interest or interests of depositors. In addition, the RBI will look into the public interest and availability of banking facilities in the proposed area of operations. While granting license, the RBI may lay down conditions to be fulfilled by the licensee when operating as a bank.

Banking Regulation Act (BRA) gives RBI wide amplitude in the granting of a license. The RBI has in recent times given out a policy papers on how it would exercise its discretion. The conditions for license for different types of banks are different as each of them would pose different risks to the financial system. ***At present, banking license for commercial banks are in three categories - payment banks, small finance banks and full-fledged commercial banks.*** The first do not give out any commercial loans while the second give loans only up to a specific amount allowed by the RBI (Rupees twenty five lakhs at present). Since the first and second categories of banks pose a lower risk, the licensing conditions are less onerous for them. The third category of banks has more onerous conditions regarding capital and character of the management. One change by the RBI in the latest policy statement is that from now on the bank licenses are to be on tap provided the applicant meets its rigorous conditions for them and it has also laid out a roadmap for payments banks to progress to small finance banks and then to full-fledged commercial banks.

The RBI license is also required for the opening of bank branches, the definition of which is very wide in the BRA to take into account all payment offices. At present, such licenses are not individually given but banking companies have been given general permission to open branches provided a spatial distribution in terms of rural and urban branches is maintained. Foreign banks wanting to open branches in India are required to have a license from the RBI. The license is granted on the basis of reciprocity (Indian banks can open branches in the country of incorporation of the foreign bank). The latest guidelines of the RBI provide that the foreign banks wanting to start a bank in India will have to do so through a subsidiary incorporated in India, as it wants to insulate the Indian limb of the business of the foreign bank from the fluctuations in the fortunes of the foreign bank in other jurisdictions.

For any company to be licensed to operate as a bank, one essential aspect which is required to be looked into is its capital. Capital of the banking company will have two aspects, initial capital and capital in relation to business. BRA concerned itself only with the initial capital and the amounts mentioned therein have only a historical importance, no longer relevant in the present times. RBI gives out the minimum capital the bank requires to have (depending upon the type of bank license applied for), but also lays out the capital which a bank needs to have in accordance with the size of business and the risk profile of its loan assets. This is in pursuance of the application of the norms agreed upon by the central banks in the Basel Accords. Basel Accords (at present we have Basel III) take into account the reality that the shareholder, who controls the management, has a limited liability. Because the liability of the shareholder is limited, the shareholder body has an incentive to push the management to take greater risks in lending so as to increase the shareholder returns. This risk reward conundrum in a limited liability entity can only be broken by requiring that the shareholder put in additional capital where the risks are greater. So now the capital requirements of a bank are based on the size of its loan book and the quality of its loan book. Less shareholder capital is required when money is lent to the government, more capital is required when money is lent to an individual backed by the security of mortgage of self occupied house and most capital is required when an unsecured loan is given for a business. Basel norms also takes into account of balance sheet exposure of banks in the form of bank guarantees, etc. The Basel capital requirements refers to capital which is available to depositors of the bank as a cushion in the event of bank not performing well. The capital can be in the form of equity shares, irredeemable preference shares and debt in form of debentures (convertible or non convertible) or bonds which are subordinate to debt due to the depositors. The capital requirements can further be divided into tier one and tier two, depending upon how permanent the capital is. Tier one comprises equity shares, irredeemable preference shares and some debentures or bonds with the condition that their redemption is dependent upon the banking company fulfilling certain conditions and it wanting to redeem it.

7.4 REGULATION IN RELATION TO THE BANK MANAGEMENT

As was observed earlier, that the law is concerned about the general character of the proposed management and as to how the affairs of the bank are conducted so that the public interest and the interests of the depositors are not affected. There

are two aspects to the above issue. One is who controls the bank that is the shareholding composition and the degree of control a body of shareholders can exercise, and the second issue comprises the quality of the management and its conduct.

It is important for the banking company's depositors as to the ***distribution of the shareholding*** and the extent of the ***control*** that ***the dominant group of shareholders*** exercises over the bank. Part of the problem is taken care of by the BRA, and part of the problem is taken care of by the conditionalities laid out by the RBI in giving the license and its powers to issue directions to the banks.

First of all the statute denies voting rights to preference shareholders irrespective of the fact that they have not been paid preferential dividend for two years or more.

Secondly, even in the case of equity shares, no shareholder can exercise voting rights in excess of ten percent of the issued equity share capital. This cap on voting powers can be increased by the RBI up to twenty six percent. Thirdly, no one on his own or in concert with others can own- five percent or more of the equity share capital or voting rights in a company without the prior permission of the RBI.

In addition to these statutory restrictions, the RBI at the time of the granting the license lays down a schedule for the dilution of the promoter of the banking company. These are to ensure that individual interests do not get equivocated with the interests of the bank and there is a diversity of shareholding and voting power so that there is sufficient control over the dominant shareholder without there being a takeover which may not be in the interests of the depositors.

Second limb of ***ensuring good management is quality of management and its conduct***. BRA covers almost all aspects of potential control over the management and almost all the aspects of a Board of Directors working which may affect the bank. The provisions may appear at some times to be repetitive.

First of all, the BRA deals with the potential ***conflict of interest between the bank and its Board***. A banking company is forbidden to lend to any director or any person in whom the director may be interested in. Further, a bank may not remit any debt due from a director or any person in whom the director may be interested in without the prior permission of the RBI. This blanket ban on power to remit extends to extension of time for repayment or change in the terms of repayment. A person to be a director must not be a proprietor of any business concern or have a substantial interest (defined by BRA) in any company or firm or be connected with it in any form if it were not a small scale industrial concern. The Act prevents a director on the board of a banking company to be a director on the board of any other company, even another banking company. The only exception granted to this ban is membership of the board of a subsidiary of the bank or that of a non-profit company. In addition, from a Chairman appointed on a whole time basis, directors to all employees of a bank, irrespective of whatever rank or office they hold, all are deemed to be public servants under Prevention of Corruption Act and can therefore be prosecuted for causing any loss to the bank by their corrupt actions.

After dealing with the conflict of interest, the BRA deals with ***the composition of the Board***. Majority of the board needs to have technical expertise specified

by the BRA, with a further requirement of special knowledge and practical experience in the case of a whole time Chairman or Managing Director (there can be only one of the two in a bank). What is important is the power of the RBI to interfere with the appointment process of the appointment of the Board, the Chairman and the Managing Director. No amendment in the articles of association or memorandum, no contract or resolution of the shareholders or the Board of Directors with regard to the appointment, termination or remuneration of a Chairman, Managing Director, Director or Chief Executive Officer shall be effective unless approved by the RBI. Other than Directors who are not whole time Directors, even the appointment, reappointment or termination of appointment of the aforesaid managerial personnel requires the prior permission of the RBI. The RBI can ask the banking company to reconstitute its Board if the composition of the Board is not in accordance with the BRA. Non compliance by the banking company of the direction would allow the RBI to remove the Director/s whose appointment is not in compliance of the law and appoint its own nominees on the Board. In the same vein, in case the RBI comes to the conclusion that the whole time Chairman or Managing Director of the company is not a fit and proper person, it may require the company to change the whole time Chairman or Managing Director and non compliance with the direction would allow the RBI to appoint its own nominee to the post. This power is in addition to the power of the RBI to appoint when the said post is vacant for an inordinately long period.

In public interest, interest of the depositors or for securing proper management of the banking company, the RBI can remove any managerial personnel (Chairman, Managing Director, Chief Executive Officer, etc.) or officer or employee from the office after following due procedure, and appoint its own nominee to the post. For the same reasons it may also appoint Additional Directors on the Board of the banking company and also in consultation with the Central Government supersede the Board of Directors and appoint an Administrator to manage the affairs of the banking company.

It would be worthwhile to note that many of these provisions with regard to managerial personnel, with suitable modifications are also applicable to cooperative banks. In the case of the public sector banks (which are governed by separate statutes by which they were formed or nationalized), the powers are exercised by the Central Government.

7.5 REGULATIONS WITH RESPECT TO ENSURING LIQUIDITY AND HEALTHY LENDING PRACTICES

As discussed above, the banking business is inherently fragile as it lends for long term purposes, from on the basis of funds which are borrowed from short term sources. Other than ensuring that the management should not be such that it may compromise the interests of the depositors, certain norms have to be in place so that liquidity is maintained and the bank's business is run in such a manner that it remains solvent. These statutory provisions came about in the background of historical experiences from some famous bank failures, which the legislature did not want to be repeated. So there are certain no go areas for the bank which the Parliament has itself prohibited, or allowed a relaxation only

with the prior permission of the RBI. As to the rest it has allowed the RBI to give guidelines or directions taking into account the best practices in the world and the economic reality of India.

First of all, a bank, in addition to banking business, can only do a business that is permitted by section 6(1) of the BRA, though the last sub-clause of section 6(1) allows the government to notify any other business or activity which a bank could engage in. What it cannot do directly, it cannot do indirectly, as well. So, no bank could have shares in excess of thirty percent of the shares in any entity not engaged in a business mentioned in section 6(1) of the BRA. This restraint on shareholding is with reference to holding in any form whatsoever i.e., as an absolute owner, mortgagee or pledgee. Pursuant to historical experience, a bank is forbidden to trade in goods and hold immovable property (which is not required for banking business) for a period of more than seven years. In addition, as the ambit of a bank's permissible activities are also circumscribed like any company by the object clause of its Memorandum of Association, and any change in the Memorandum of Association of the bank requires the prior approval of the RBI. RBI can also caution or prohibit a bank or banks from entering into a transaction or class of transactions based upon its apprehensions. The reason for this comprehensive set of limitations is that the bank which has an opportunity to use the money parked by its depositors, should limit itself to the business related to money lending and allied activities. Banks should not venture into a full-fledged business entity by itself, as then the chances are that the easy liquidity made available to it by the unsuspecting depositors may incentivize the management to take risky bets and suppress losses and thus turning the bank in effect into a ponzi scheme, satisfying old depositors by new deposits of the unsuspecting customers. Moreover, the drafters of the BRA were concerned that the interests of the depositors should not be made subservient to the interests of other creditors of the bank. In pursuance of this objective, there is a prohibition on banks in giving a floating charge on its assets to any creditor without the prior approval of the RBI.

In addition to the restraints imposed expressly by it, the BRA gives rule making powers to the RBI. Though BRA uses the term guidelines and directions for such rules made by the RBI, they are binding on the bank, though a lending decision in contravention of them may still be enforceable in a court of law. BRA recognizes that such guidelines may be specific to a bank or may be general, applicable to all or a class of banks or a bank. The RBI, when granting a license, may grant it subject to conditions including conditions relating to loans which a bank can give, as it does in the case of small finance banks and payment banks. Then section 21 of the BRA allows the RBI to lay down the policy for bank advances, generally for all or specific to a bank, including laying down the purpose, margins for a security, considerations for determining maximum exposures which a banking company can have to an individual, company or group as well as rates of interests and conditions for financial accommodation of a borrower. It is in pursuance of these powers that the RBI lays out the policies for social sector lending, syndicate lending for large ticket loans, prompt corrective action for weak banks, margin requirements for different types of securities including market securities, purposes for which no money could be lent, minimum interest chargeable and calculation of interest rate in the case of floating rate loans, etc.

Even otherwise, the RBI in public interest or in the interests of the banking policy or interest of depositors or for proper management of the banking company

may give general or specific directions to banks. It is in pursuance of this power the RBI has implemented the Basel Accord norms in India and given banks guidelines as to income recognition (a frequent cause of bank failure by suppressing its weaknesses), NPA recognition and classification, debt restructuring of sick enterprises and hauling the insolvent enterprises to the NCLT for insolvency proceedings. As per one of its directions, every bank should have a risk management committee to monitor the lending practices of the bank so as to ensure its stability.

To handle potential liquidity crisis in a bank, even if it is well run, the law follows a two pronged approach. The first is to prevent a sudden abnormal surge in the need for liquidity due to panic amongst bank customers and the second approach is to ensure that the bank has enough investment in assets which can be considered liquid so that cash could be rustled up whenever the need for it arises. To prevent panic, BRA makes it a punishable offence any act which is designed to undermine the confidence of depositors in a banking company. Further, the depositors are automatically given a deposit insurance to the extent of Rupees five lakhs. To ensure liquidity in case of sudden demand, in addition to the lender of last resort role of the RBI under section 19 of the RBI Act to the scheduled banks (a lending done at the Bank Rate fixed by the RBI), every scheduled bank has to maintain a deposit with RBI a certain percentage (fixed by the RBI, but at a minimum three percent) of its time and demand liabilities. This cash reserve ratio helps in the settlement in interbank transactions via the RBI and also is an emergency liquid reserve available in an emergency. In addition to cash reserve ratio, the banks have also to invest a certain fixed percentage of deposits in assets which can be liquidated easily to raise cash. Called statutory liquidity ratio, these assets are generally government bonds or bonds guaranteed by the government, though few other assets have also been qualified to be part of the statutory liquidity ratio. Subject to the floor and ceiling rates prescribed by the BRA, the cash reserve ratio and the statutory liquidity ratio is fixed by the RBI. In addition to these three means to ensure liquidity, the RBI has also provided a repo window to the banks. Essentially, a repo transaction is a short term lending disguised as a sale and repurchase transaction between the parties. Securities are sold by the bank to the RBI with an understanding that they will be bought back by the bank after a specified period (usually a few weeks), at a fixed rate which represents the price of original sale and a specified interest rate called the repo rate (fixed by the Monetary Policy Committee).

7.6 REPORTING REQUIREMENTS, INSPECTIONS AND AUDIT

It is important for the regulator to be aware of the health of the regulated entities. This is not just to see whether compliance is in accordance with the letter and spirit of the regulations, but also to allow a preemptive action to be taken to ensure that the regulated entity does not fail or its failure, if inevitable, does not pose a systemic risk. ***The three pillars of this regulatory awareness are regular reporting, statutory audits by trusted auditors and inspections.*** In the case of banks, these three serve as an additional avenue of information in addition to what is gleaned by the RBI from the working of the payment system.

The banks have to maintain the cash reserve ratio, statutory liquidity ration and a minimum of seventy five percent of assets in India equal to its demand and

time liabilities in India. These three ratios have to be regularly calculated at given intervals, so the RBI also needs to be informed about their compliance. Therefore, on the last Friday of every month, every bank has to submit in the given format data with regard to the liabilities and assets of the bank along with any other information which the RBI may ask for. Further, under the RBI Act, the banks have to share with the RBI credit information (which is much more than advances made by the banks and includes information about guarantees, securities and other potential liabilities), which the RBI can share with other banks (express provision for sharing of such information was necessary because of the customary law that banks should maintain confidentiality about their customers financial affairs). This was thought of as a way to reduce systemic risk. BRA now allows the RBI to publish any information received by it from the banks as well as any credit information disclosed under Credit Information Companies (Regulation) Act. This power should be read in consonance with the power given in the RBI Act by which the information shared with the public should not name the borrower and the lender.

The second limb of maintaining financial health through awareness is audit. While the company law provisions with regard to audit are also applicable in so far as they are not in conflict with the BRA, in the audit process of a company the RBI has a certain control as it is, on behalf of the depositors, also interested in the audit process. The auditor in addition to being deemed to be a public servant under Prevention of Corruption Act, has to be approved by the RBI before his/her appointment, reappointment or removal in addition to following the Companies Act in such matters (RBI has a list of approved auditors). The RBI can also order a special audit of the banking company, to be conducted either by the banking company's auditor or any other auditor appointed by the RBI. The auditors are also supposed to report on matters directed by RBI to be looked into and the report of the auditors, normal as well as the special shall be shared with RBI.

The third important pillar of this process to find the truth is the inspection powers of RBI, which it may do so on its own or shall do so on the directions of the Central Government. During inspections not only the records of the bank will be scrutinized, but the officers and employees may also be examined under oath.

7.7 PENAL POWERS

Any regulator's powers have three components i.e., legislative (rule making), executive and judicial (power to impose penal sanctions). The third component is as important as the first two components because it is the third component along with its expertise in the subject matter which puts the fear of the regulator in the hearts of the regulated. What can be the penal consequences for non observance of the regulatory guidelines and directions other than that of the change of key personnel, supersession of Board, nomination of additional members on the Board etc., which the RBI can exercise or threaten to exercise to ensure compliance?

At the *first* level the RBI can deny the permissions which can be expected from it, or deny the enjoyment by the regulated entity (banking company) of the general permissions granted to the sector. So as a disciplinary step it may not sanction the renewal of a Chairman or Managing Director's appointment, or tell a bank not to open new branches under a general permission given to all banks.

The **second** method of penalizing a bank is to forbid it from doing what constitutes the core of the banking business, a denial of which might mean a slow death of the bank. So, using its powers to prohibit a certain transaction or class of transactions generally or specifically, it can impose restrictions on a bank on making advances or certain types of advances. The Central Government, if it is convinced on the basis of an inspection report by the RBI that the banking company's affairs are being run in a manner which is detrimental to the interests of the depositors, then it may prohibit the bank from taking fresh deposits. Failure to comply with cash reserve ratio may also result in the RBI prohibiting the bank from accepting fresh deposits.

The **third** way of penalizing is imposing a fine on the bank and/or its officers. So non observance of the mandated cash reserve ratio and statutory liquidity ratio would result in the imposition of penal interest on the bank to the extent it is short of the required ratio and in addition the officers of the bank may be liable for fine calculated on the basis of per day the bank was in default. Penalty is also prescribed to those responsible for furnishing misleading information, not furnishing the asked for information, accepting fresh deposits in contravention of the prohibition or contravening the provisions of the BRA. However, a court can take cognizance of the offence only if the RBI approaches it. The RBI also has the powers to impose fines on its own.

The **fourth** way the penal consequence visits the non compliant bank is the cancellation of license of the bank itself or of its branch. There are certain conditions which BRA requires for grant of license (discussed above) and in addition there can be certain conditions which the RBI may impose in granting a license. If these conditions are not being fulfilled then the RBI may cancel the license issued by it.

The **fifth** way in which the RBI may discipline the bank is by initiating the winding up of the banking company. The RBI may make an application before the Tribunal for winding up a banking company if it is convinced that the affairs of the banking company are being conducted in a manner detrimental to the interests of the depositors. Non adherence to the capital requirements of a bank, non compliance with the conditions of the license, prohibition from acceptance of fresh deposits and non compliance with the provisions of the BRA are also grounds for initiating such action in addition to the insolvency of the bank.

The **sixth** tool to discipline a bank is by penalizing the shareholders without winding up the bank. The Central Government can acquire a banking company (on the basis of a report by the RBI) if it is in repeated violation of the RBI directions or the affairs of the banking company are being conducted in a manner detrimental to the interests of the shareholders. There is provision for shareholder compensation for the expropriation, but no control premium is paid. In a similar vein the RBI can reconstruct a banking company or amalgamate it with another after imposing a moratorium on the bank. Here, in addition to the shareholders, the depositors too may lose a part of their deposits (a 'haircut').

7.8 SUMMARY

Regulation of financial institutions is extremely important because of the unique nature of a financial asset. It is an asset which derives its value by description

and its own existence is dependent upon the solvency/existence of the parties. Amongst all the players in a financial system, the banks are the most unstable of the lot because of their business model. Regulation seeks to reduce the risks of operation to the bank itself, to the banking system and to the overall financial system and the economy. Since banking as an industry keeps in evolving and new risks keep on getting identified and the relative importance of some of the old identified risks may get reduced, regulatory legal structure needs to be flexible enough to take into account the new challenges with alacrity. Indian regulatory structure for the banking industry tries to merge flexibility, so as to take into account the global best practices and Indian reality, with some certainties as to the considerations which will go into the rule making. Some provisions also seek to ease the hurdles in the smooth conduct of the banking business. Therefore, provisions for evidence by banks in Bankers Book of Evidence Act, nomination in the BRA and sharing of credit information under the RBI Act and Credit Information Companies (Regulation) Act seek to remove the landmines which are there in law in the conduct of banking business.

7.9 SELF ASSESSMENT QUESTIONS

- 1) “RBI is the banker of the last resort”. Do you agree with the statement?
- 2) Stringent terms and conditions are required to be complied with for obtaining a bank license. Please explain such terms and conditions.
- 3) Discuss the interface of Banking Regulation Act with other laws.
- 4) Discuss the socio-economic impact of the banking system in any country.
- 5) Discuss the role of shareholders in banking companies.
- 6) Discuss the role of Central Government in controlling and regulating the banking sector in India.

7.10 FURTHER READINGS

- 1) Gupta, S.N., 2017, *The Banking Law In Theory And Practice*, Universal Law Publishing
- 2) M.L. Tannan, M.L., 2014, *Banking Law And Practice In India*, Lexis Nexis

UNIT 8 FOREIGN EXCHANGE MANAGEMENT AND RELATED REGULATIONS

Objectives

After studying this unit you should be able to:

- understand by the term 'Foreign Exchange'
- Explain the objectives and background of Foreign Exchange Management Act (FEMA)
- Identify the prohibited transactions under the FEMA
- Describe the process of regulation and management of Foreign Exchange
- Distinguish between Person resident in India and Person Non-resident in India
- Differentiate between Capital account transactions and current transactions

Structure

- 8.1 Introduction
- 8.2 Objectives of FEMA
- 8.3 Background of FEMA
- 8.4 FEMA: An Overview
- 8.5 Important Definitions and Concepts
- 8.6 Regulation & Management of Foreign Exchange
- 8.7 Types of Transactions under FEMA
- 8.8 Capital Account Transactions
- 8.9 Current Account Transactions
- 8.10 Authorised Person
- 8.11 Contraventions & Penalties
- 8.12 Provision for Appeal
- 8.13 Directorate of Enforcement
- 8.14 Compounding of Offences under FEMA
- 8.15 Summary
- 8.16 Self Assessment Questions
- 8.17 Further Readings/References

8.1 INTRODUCTION

This Unit is designed to introduce the important regulations related to the foreign exchange management in India. It aims to provide the basic understanding of different concepts under the Foreign Exchange Management Act, 1999, and its related rules and regulations. It would also help the students to have a broad understanding of how foreign exchange is managed in India and what is the regulatory framework which govern the people who deal with foreign exchange.

8.2 OBJECTIVES OF FEMA

The Foreign Exchange Management Act (Act No 42 of 1999) has been formulated by the Central Government to consolidate and amend the law relating to foreign exchange with the objective of facilitating external trade and payments and for promoting the orderly development and maintenance of foreign exchange market in India.¹

8.3 BACKGROUND OF FEMA

The Defence of India Act, 1939, was temporary yet the first legislative attempt to regulate and control the foreign exchange in India. With an aim to settle the foreign exchange crisis in the country, the Foreign Exchange Regulation Act was first enacted in 1947; however, it was further replaced by the FERA 1957. The immediate predecessor of FEMA was the Foreign Exchange Regulation Act, 1973. It was enacted with an objective to regulate the foreign exchange rather than managing it. FERA aimed to regulate the foreign exchange by preventing the outflow of Indian currency, regulating dealings in foreign exchange and securities, by imposing several kinds of restrictions on transactions involving foreign exchange and on persons dealing with foreign exchange. FERA also aimed to only conserve the foreign exchange and regulate the use of it. FERA provided for number of criminal offences with *mens rea* and had provision for easy arrest by the Enforcement Directorate, even without an arrest warrant.

In the light of the economic liberalisation policy adopted by the Government of India in 1991-92, and the changing economic and financial landscape in the country, there was a need to modify the foreign exchange regulation also. Hence, with an aim to modify the FERA and adopt more liberal policy and approach towards foreign exchange, the FERA was replaced by the Foreign Exchange Management Act, 1999. The FEMA 1999 was also formulated to encourage and attract more foreign investments in the country; hence the regulations related to the foreign investments were also simplified. Many provisions under FERA were liberalised or removed to facilitate foreign exchange; however, few others were still included under the FEMA.

The FEMA is more transparent in its approach and implementation than its predecessor. It marks and very clearly identifies those areas and situations which require specific approval by the RBI or the Central Government for acquiring or holding foreign exchange. The philosophical approach was shifted from that of conservation of foreign exchange to one of facilitating trade and payments as well as developing orderly foreign exchange market.

8.4 FEMA: AN OVERVIEW

The Foreign Exchange Management Act, 1999, provides the legal framework for the proper management and administration of the foreign exchange transactions in the country. The Act came into force from June 1, 2000 and since then, has been amended from time to time according to the changing economic policies and objectives of the government. There are approximately six Rules framed by the Central Government and twenty three Regulations notified by the Reserve Bank of India (RBI) under the FEMA Act.

The Act extends to the whole of India and also applies to all branches, offices and agencies outside India owned or controlled by a person resident in India and also to any contravention thereunder committed outside India by any person to whom this Act applies.

The statutory power under this Act empowers the RBI as well as the Central Government to frame and pass regulations and the rules from time to time, which are consistent with the foreign trade policy of the country. The Act provides for a legislative and regulatory framework, for inbound and outbound investments, and facilitates trade and business opportunity between Indian and other countries. FEMA lays down provisions for current account and capital account transactions. The RBI is the regulatory body and plays a controlling role in the management of the foreign exchange. The Act also makes provisions for enforcement, penalties, adjudication and appeal. FEMA along with the various rules and regulation applies to different practical aspects of the management of foreign exchange in India.

Structure of FEMA-

The Act is divided into 7 chapters, which are further divided into 49 sections. The following is the scheme of chapters under FEMA-

CHAPTER I – Preliminary (Section 1&2)

CHAPTER II- Regulation and Management of Foreign Exchange (Section 3 –9)

CHAPTER III – Authorised Person (Section 10 –12)

CHAPTER IV – Contravention and Penalties (Section 13-15)

CHAPTER V – Adjudication and Appeal (Section 16- 35)

CHAPTER VI – Directorate of Enforcement (Section 36-38)

CHAPTER VII- Miscellaneous (Section 39 – 49)

It also includes-

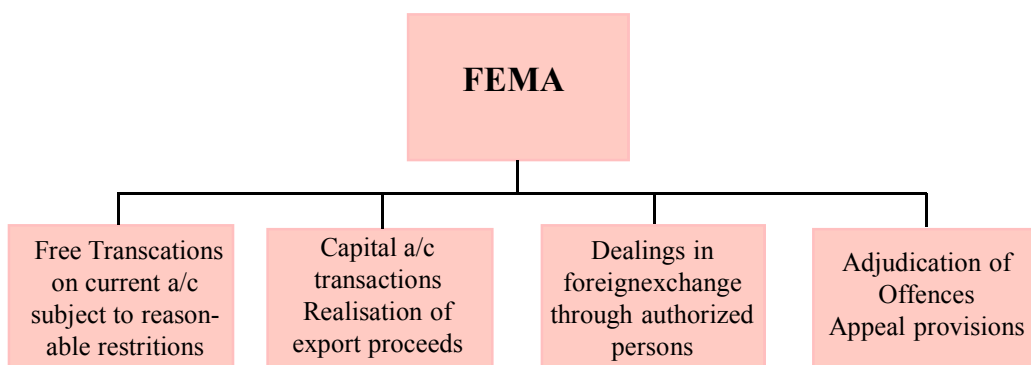
- Rules made by Ministry of Finance under Section 46 of FEMA (Subordinate or delegated Legislations)
- Regulations made by RBI under Section 47 of FEMA (Subordinate or delegated Legislations)
- Master Direction issued by RBI every year
- Foreign Direct Investment policy issued by the Department for Promotion of Industry and Internal Trade (DPIIT).
- Notifications and Circulars issued by Reserve Bank of India

Rules made under FEMA:

- 1) FEM (Encashment of Draft, Cheque, Instrument and Payment of Interest) Rules, 2000
- 2) FEM (Authentication of Documents) Rules, 2000
- 3) FEM (Current Account Transaction) Rules, 2000
- 4) FEM (Adjudication Proceedings and Appeal) Rules, 2000
- 5) FEM (Compounding Proceedings) Rules, 2000
- 6) The Appellate Tribunal for Foreign Exchange (Recruitment, Salary and Allowances and Other Conditions of Service of Chairperson and Members) Rules, 2000.

Regulations made under FEMA-

- 1) FEM (Acquisition and Transfer of Immovable Property outside India) Regulations, 2015
- 2) FEM (Borrowing and Lending in Rupees) Regulations, 2000
- 3) FEM (Borrowing or Lending in Foreign Exchange) Regulations, 2000
- 4) FEM (Deposit) Regulations, 2016
- 5) FEM (Export and Import of Currency) Regulations, 2015
- 6) FEM (Guarantees) Regulations, 2000
- 7) FEM (Acquisition and Transfer of Immovable Property in India) Regulations, 2000
- 8) FEM (Establishment in India of Branch office or a Project office or any other Place of Business) Regulations, 2016
- 9) FEM (Export of Goods and Services) Regulations, 2015
- 10) FEM (Foreign Currency Accounts by a Person Resident in India) Regulations, 2015
- 11) FEM (Insurance) Regulations, 2015
- 12) FEM (Investment in Firm or Proprietary Concern in India) Regulations, 2000
- 13) FEM (Manner of Receipt and Payment) Regulations, 2016
- 14) FEM (Permissible Capital Account Transactions) Regulations, 2000
- 15) FEM (Possession and Retention of Foreign Currency) Regulations, 2015
- 16) FEM (Realization, Repatriation and Surrender of Foreign Exchange) Regulations, 2015
- 17) FEM (Remittance of Assets) Regulations, 2016
- 18) FEM (Transfer or Issue of Security by a person Resident outside India) Regulations, 2017
- 19) FEM (Foreign Exchange Derivative Contracts) Regulations, 2000
- 20) FEM (Transfer or Issue of any Foreign Security) Regulations, 2004
- 21) FEM (Crystallization of inoperative Foreign Currency Deposits) Regulations, 2014
- 22) F.E.M (Transfer or Issue of any foreign Security) Regulations, 2004
- 23) FEM (International Financial Services Centre) Regulations, 2015
- 24) FEM (Regularization of Assets Held Abroad by a Person Resident in India) Regulations, 2015.



8.5 IMPORTANT DEFINITIONS AND CONCEPTS

Persons Resident in India² means:

- i) a person residing in India for more than one hundred and eighty-two days during the course of the preceding financial year but does not include—
 - A) a person who has gone out of India or who stays outside India, in either case:
 - a) for or on taking up employment outside India, or
 - b) for carrying on outside India a business or vocation outside India, or
 - c) for any other purpose, in such circumstances as would indicate his intention to stay outside India for an uncertain period;
 - B) a person who has come to or stays in India, in either case, otherwise than—
 - a) for or on taking up employment in India, or
 - b) for carrying on in India a business or vocation in India, or
 - c) for any other purpose, in such circumstances as would indicate his intention to stay in India for an uncertain period;
- ii) any person or body corporate registered or incorporated in India,
- iii) an office, branch or agency in India owned or controlled by a person resident outside India,
- iv) an office, branch or agency outside India owned or controlled by a person resident in India;

Person resident outside India³ means a person who is not resident in India.

Mr. X landed in India on 1st August 2019 to take up employment.

For the Financial Year 2018-19, he was not in India. So for the financial year 2018-19 he is not resident of India.

For the Financial Year 2019-20, he was in India for more than 182 days, so for the financial year 2019-20 days, he is resident of India.

Authorized persons⁴ means an authorised dealer, money changer, off-shore banking unit or any other person who are authorized to deal in foreign exchange or foreign securities.

Capital Account Transaction⁵ means a transaction which alters the assets or liabilities, including contingent liabilities, outside India of persons resident in India or assets or liabilities in India of persons resident outside India, and includes transactions referred to in sub-section (3) of section 6 of the Act.

Current account transaction⁶ means a transaction other than a capital account transaction and without prejudice to the generality of the foregoing such transaction includes;

- i) payments due in connection with foreign trade, other current business, services, and short-term banking and credit facilities in the ordinary course of business,
- ii) payments due as interest on loans and as net income from investments,
- iii) remittances for living expenses of parents, spouse and children residing abroad, and
- iv) expenses in connection with foreign travel, education and medical care of parents, spouse and children;

Foreign currency⁷ means any currency other than Indian currency.

Foreign exchange⁸ means foreign currency and includes;

- i) deposits, credits and balances payable in any foreign currency,
- ii) drafts, travellers cheques, letters of credit or bills of exchange, expressed or drawn in Indian currency but payable in any foreign currency,
- iii) drafts, travellers cheques, letters of credit or bills of exchange drawn by banks, institutions or persons outside India, but payable in Indian currency

8.6 REGULATION & MANAGEMENT OF FOREIGN EXCHANGE

Chapter II of the FEMA Act, 1999, provides for the provisions related to the regulation and management of foreign exchange in India. There can be no dealing in foreign exchange without the general or special permission of the Reserve Bank of India. The Act also does not empower the RBI or any other person to directly handle the foreign exchange. For this, the RBI can authorize the “Authorized persons” and issue directions to such authorized persons from time to time.⁹ Other than the ordinary or special permission of the RBI under the Act, or other than the manner provided under the Act, its rules or regulations, no person is allowed to:

- a) deal in or transfer any foreign exchange or foreign security to any person not being an authorised person;
- b) make any payment to or for the credit of any person resident outside India in any manner;
- c) receive otherwise through an authorised person, any payment by order or on behalf of any person resident outside India in any manner.¹⁰
- d) enter into any financial transaction in India as consideration for or in association with acquisition or creation or transfer of a right to acquire, any asset outside India by any person.

A financial transaction means making any payment to or for the credit of any person or receiving any payment for, by order or on behalf of any person. Financial transaction also includes drawing, issuing or negotiating any bill of exchange or promissory note or transferring any security or acknowledging any debt.

Situation 1) Whether Mr. X, a resident of USA, asks his uncle staying in Delhi to make a payment of Rs 20000 to Mr. Y?

Ans: No. Such payment is not permitted under clause (b) of section 3 of the Act.

Situation 2) Mr. X, a resident of Germany asks his Company Secretary in India to form a Company in India and proposes to reimburse all the expenses after the formation of the company. Whether, the Indian Company Secretary, can spend for the above purpose on behalf of Mr. X?

Ans: No. Such payment is not permitted under clause (b) of section 3 of the Act.

There is a blanket prohibition on a person resident in India to acquire, hold, own, possess or transfer any foreign exchange, foreign security or any immovable property situated outside India, except as permitted under the Act, Rules or Regulations thereunder.¹¹

8.7 TYPES OF TRANSACTIONS UNDER FEMA

The Act recognises two types of transactions. They are; 1. Capital Account Transactions and, 2. Current Account Transactions. Each type of the transaction is governed by a relevant regulation. Let us discuss these in detail.

8.8 CAPITAL ACCOUNT TRANSACTIONS¹²

The capital account transactions are governed by the Act and the FEMA (Permissible Capital Account Transactions) Regulations 2000. Such transactions which alter the assets or liabilities, including contingent liabilities, outside India of persons resident in India or assets or liabilities in India of persons resident outside India are called as capital account transactions.¹³ The Act allows any person to sell or draw foreign exchange to or from an authorised person for a capital account transaction subject to the condition that the RBI may, in consultation with the Central Government, specify¹⁴-

- i) The permissible classes or classes of capital account transactions
- ii) The limit upto which foreign exchange shall be admissible for such transactions
- iii) Any condition which may be placed on such transactions

However, the Reserve Bank cannot impose any restriction on the drawal of foreign exchange for payments which are due on account of amortization of loans or not depreciation of direct investments in the ordinary course of business.

Similarly, the Central Government, in consultation with the RBI can also prescribe¹⁵—

- a) the permissible class or classes of capital account transactions, not involving debt instruments;
- b) the limit up to which foreign exchange shall be admissible for such transactions; and
- c) any conditions which may be placed on such transactions.

Powers of RBI to regulate the foreign exchange¹⁶

The Act empowers the RBI to prohibit, restrict or regulate the following-

- a) transfer or issue of any foreign security by a person resident in India;
- b) transfer or issue of any security by a person resident outside India;
- c) transfer or issue of any security or foreign security by any branch, office or agency in India of a person resident outside India;
- d) any borrowing or lending in foreign exchange in whatever form or by whatever name called;
- e) any borrowing or lending in rupees in whatever form or by whatever name called between a person resident in India and a person resident outside India;
- f) deposits between persons resident in India and persons resident outside India;
- g) export, import or holding of currency or currency notes;
- h) transfer of immovable property outside India, other than a lease not exceeding five years, by a person resident in India;
- i) acquisition or transfer of immovable property in India, other than a lease not exceeding five years, by a person resident outside India;
- j) giving of a guarantee or surety in respect of any debt, obligation or other liability incurred—
 - i) by a person resident in India and owed to a person resident outside India; or
 - ii) by a person resident outside India.

Modes of Acquiring Property in and Outside India-

The FEMA Act 1999 lays down the mechanism for acquiring property in India by a non-resident and outside India by a resident. The Act provides the following-

I) Modes of acquiring property outside India by a resident-

A person resident in India can hold, own, transfer or invest in foreign currency, foreign security or any immovable property situated outside India, if such currency, security or property was acquired, held or owned by such person when he was resident outside India or inherited from a person who was resident outside India.¹⁷In this regard, the provisions laid down under the Foreign Exchange Management (Acquisition and transfer of immovable property outside India) Regulations, 2015 state that the following-

- 1) A resident can acquire immovable property outside India by way of gift or inheritance from:
 - a) a person referred to in sub-section (4) of Section 6 of the Act, or referred to in clause (b) of regulation 4; or
 - b) a person resident in India who had acquired such property on or before July 8, 1947 and continued to be held by him with the permission of the Reserve Bank.
 - c) a person resident in India who has acquired such property in accordance with the foreign exchange provisions in force at the time of such acquisition.¹⁸

- 2) A resident can acquire immovable property outside India by way of purchase out of foreign exchange held in Resident Foreign Currency (RFC) account maintained in accordance with the Foreign Exchange Management (Foreign Currency accounts by a person resident in India) Regulations, 2015;
- 3) A resident can acquire immovable property outside India jointly with a relative who is a person resident outside India, provided there is no outflow of funds from India;

II) Modes of acquiring property in India by a non-resident

A person resident outside India is also permitted to hold, own, transfer or invest in Indian currency, security, or any immovable property situated in India if such currency, security or property was acquired, held or owned by such person when he was resident in India or inherited from a person who was resident in India.¹⁹ The provisions related to acquisition of immovable property by a non-resident or Overseas Citizen of India (OCI) have been laid down in Foreign Exchange Management (Foreign Currency accounts by a person resident in India) Regulations, 2015.

Acquisition of Immovable Property by a non-resident or OCI²⁰

Other than agricultural land, plantation property and farm house, an NRI or OCI can-

- acquire by way of purchase any immovable property in India²¹.
- acquire by way of gift any immovable property in India from person resident in India or from an NRI or an OCI who in any case is a relative as defined in section 2(77) of the Companies Act, 2013.²²
- acquire any immovable property in India by way of inheritance from a person resident outside India who had acquired the property in accordance with the provisions of the foreign exchange law in force at the time of acquisition.²³
- acquire any immovable property in India by way of inheritance from a person resident in India.²⁴

Similarly a non-resident or OCI can also transfer any immovable property to a person resident in India under the Foreign Exchange Management (Foreign Currency accounts by a person resident in India) Regulations, 2015.

Although, the Act as well as the Regulations facilitate the acquisition of immovable property, the Reserve Bank of India has wide powers to regulate, prohibit, restrict establishment in India of a branch, office or other place of business by a person resident outside India for carrying on any activity relating to such branch, office or other place of business.²⁵

Classes of Capital Account Transactions

There are two main classes of capital account transactions which are permissible as per the Schedule I & II to Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000;²⁶ viz-

1) Classes of capital account transactions of Persons resident in India

- Investment by a person resident in India in foreign securities

- Foreign currency loans raised in India and abroad by a person resident in India
- Transfer of immovable property outside India by person resident in India
- Guarantees issued by a person resident in India in favour of a person resident outside India
- Export, import and holding of currency/currency notes
- Remittance outside India of capital assets of a person resident in India
- Loans and overdrafts by a person resident in India to a person resident outside India
- Maintenance of foreign currency accounts in India and outside India by a person resident in India
- Taking out of insurance policy by a person resident in India from an insurance company outside India
- Loans and overdrafts by a person resident in India to a person resident outside India
- Sale and purchase of foreign exchange derivatives in India and abroad and commodity derivatives abroad by a person resident in India

Examples of capital account transaction would include making equity investment in any other country, transfer including sale of immovable property situated outside India by a person resident in India.

2) Classes of capital account transactions of persons resident outside India

- Investment in India by a person resident outside India, that is to say:
 - o issue of security by a body corporate or an entity in India and investment therein by a person resident outside India; and
 - o investment by way of contribution by a person resident outside India to the capital of a firm or a proprietorship concern or an association of persons in India.
- Acquisition and transfer of immovable property in India by a person resident outside India
- Guarantee by a person resident outside India in favour of, or on behalf of a person resident in India
- Import and export of currency/currency notes into/from India by a person resident outside India.
- Deposits between a person resident in India and a person resident outside India
- Foreign Currency accounts in India of a person resident outside India
- Remittance outside India of capital assets in India of a person resident outside India.

Subject to the provisions of the Act or the rules or regulations or direction or orders made or issued thereunder, any person may sell or draw foreign exchange to or from an authorised person for a capital account transaction specified in the Schedules provided that the transaction is within the limit, if any, specified in the regulations relevant to the transaction.²⁷

The FEMA (Permissible Capital Account Transactions) Regulations 2000²⁸ also envisage that save as otherwise provided in the Act, rules or regulations made thereunder, no person is allowed to undertake or sell or draw foreign exchange to or from an authorised person for any capital account transaction.²⁹ Similarly, no person resident outside India can make investment in India, in any form, in any company or partnership firm or proprietary concern or any entity, whether incorporated or not, which is engaged or proposes to engage in the³⁰-

- Business of chit fund, or
- As Nidhi company, or
- In agriculture or plantation activities, or
- In real estate business or construction of farm houses, or
- In trading of Transferable Development Rights (TDRs)

For this purpose, the payment for investment can be made by remittance from abroad through normal banking channels or by debit to an account of the investor maintained with an authorised person in India in accordance with the regulations made by the Reserve Bank under the Act.³¹ However, every person selling or drawing foreign exchange to or from an authorised person for a capital account transaction is required to furnish a declaration to the RBI in the form and within the time specified in the regulations relevant to the transaction.³²

8.9 CURRENT ACCOUNT TRANSACTIONS

Transactions other than a capital account transaction are current account transaction. They include the following transactions³³—

- i) payments due in connection with foreign trade, other current business, services, and short-term banking and credit facilities in the ordinary course of business,
- ii) payments due as interest on loans and as net income from investments,
- iii) remittances for living expenses of parents, spouse and children residing abroad, and
- iv) expenses in connection with foreign travel, education and medical care of parents, spouse and children.

The Act allows any person to sell or draw foreign exchange to or from an authorised person if such sale or drawl is a current account transaction. However, the Central Government may, in public interest and in consultation with the Reserve Bank, impose reasonable restrictions for current account transactions.³⁴

The Foreign Exchange Management (Current Account Transactions) Rules, 2000 defines the term “Drawal” to mean drawal of foreign exchange from an authorised person and includes opening of Letter of Credit or use of International Credit Card or International Debit Card or ATM Card or any other thing by whatever name called which has the effect of creating foreign exchange liability.³⁵

Rule 3 imposes prohibition on drawal of foreign exchange by any person for the following purpose³⁶:

- a) a transaction specified in the Schedule I; or

- b) a travel to Nepal and/or Bhutan; or
- c) a transaction with a person resident in Nepal or Bhutan. This prohibition may be exempted by RBI subject to such terms and conditions as it may consider necessary to stipulate by special or general order.

Rule 4 requires prior approval of the Government of India for the transactions as specified in Schedule II. However, this does not apply to the cases where the payment is made out of funds held in Resident Foreign Currency Account (RFC) of the remitter.

Rule 5 governs every drawal of foreign exchange for transactions included in Schedule III. However, it does not apply to those cases where the payment is made out of funds held in Resident Foreign Currency (RFC) Account of the remitter.

Schedule I- Transactions which are prohibited

- 1) Remittance out of lottery winnings.
- 2) Remittance of income from racing/riding etc. or any other hobby.
- 3) Remittance for purchase of lottery tickets, banned/proscribed magazines, football pools, sweepstakes, etc.
- 4) Payment of commission on exports made towards equity investment in Joint Ventures/ Wholly Owned Subsidiaries abroad of Indian companies.
- 5) Remittance of dividend by any company to which the requirement of dividend balancing is applicable.
- 6) Payment of commission on exports under Rupee State Credit Route, except commission upto 10% of invoice value of exports of tea and tobacco.
- 7) Payment related to “Call Back Services” of telephones. 8. Remittance of interest income on funds held in Non-Resident Special Rupee (Account) Scheme.

Schedule II- Transactions which require prior approval of the Central Government

S.No.	Purpose of Remittance	Approval of
1.	Cultural Tours	Ministry of Human Resources Development (Department of Education and Culture)
2.	Advertisement in foreign print media for the purposes other than promotion of tourism, foreign investments and international bidding (exceeding USD 10,000) by a State Government and its PSUs	Ministry of Finance (Department of Economic Affairs)
3.	Remittance of freight of vessel chartered by a PSU	Ministry of Surface Transport (Chartering Wing)
4.	Payment of import through ocean transport by a government department or a PSU on CIF basis	Ministry of Surface Transport, (Chartering Wing)

5.	Multi-modal transport operators making remittance to their agents abroad.	Registration Certificate from the Director General of Shipping
6.	Remittance of hiring charges of transponders by: • TV Channels • Internet Service Providers	Ministry of Information and Broadcasting (Ministry of Communication and Information Technology)
7.	Remittance of container detention charges exceeding the rate prescribed by Director General of Shipping	Ministry of Surface Transport (Director General of Shipping)
8.	Remittance of prize money/ sponsorship of sports activity abroad by a person other than International/ National/ State Level sports bodies, if the amount involved exceeds USD 100,000	Ministry of Human Resources Development
9.	Remittance for membership of P & I Club	Ministry of Finance (Insurance Division)

However, if the payment is made out of funds held in Resident Foreign Currency (RFC) Account of the remitter, prior approval of Government of India will not be required.

Schedule III- Transactions which require prior approval of the Reserve Bank of India

- A) **Facilities for individuals**— Individuals can avail of foreign exchange facility for the following purposes within the limit of USD 2,50,000 only. Any additional remittance in excess thereof requires prior approval of the Reserve Bank of India.
- 1) Private visits to any country (except Nepal and Bhutan)
 - 2) Gift or donation exceeding USD 5,000 per remitter/donor per annum
 - 3) Exchange facility or going abroad for employment exceeding USD 100,000 or amount prescribed by country of emigration
 - 4) Emigration
 - 5) Maintenance of close relatives abroad
 - i) exceeding net salary (after deduction of taxes, contribution to provident fund and other deductions) of a person who is resident but not permanently resident in India and –
 - a) is a citizen of a foreign State other than Pakistan; or
 - b) is a citizen of India, who is on deputation to the office or branch or subsidiary or joint venture in India of such foreign company.
 - ii) exceeding USD 100,000 per year, per recipient, in all other cases.
 - 6) Release of foreign exchange, exceeding USD 25,000 to a person irrespective of period of stay, for business travel, or attending a

conference or specialised training or for meeting expenses for meeting medical expenses, or check-up abroad, or for accompanying as attendant to a patient going abroad for medical treatment/ check-up.

- 7) Expenses in connection with medical treatment abroad exceeding the estimate from the doctor in India or hospital/doctor abroad.
- 8) Studies abroad exceeding the estimate from the institution abroad or USD 100,000, per academic year, whichever is higher.
- 9) Any other current account transaction

The FEM (Current Account Transaction) Rules, 2000, also provides that a person who is resident but not permanently resident in India and-

- a) is a citizen of a foreign State other than Pakistan; or
- b) is a citizen of India, who is on deputation to the office or branch of a foreign company or subsidiary or joint venture in India of such foreign company, may make remittance upto his net salary (after deduction of taxes, contribution to provident fund and other deductions).

A person resident in India on account of his employment or deputation of a specified duration (irrespective of length thereof) or for a specific job or assignments, the duration of which does not exceed three years, is a resident but not permanently resident. It is to be noted that a person other than an individual may also avail of foreign exchange facility, mutatis mutandis, within the limit prescribed under the said Liberalised Remittance Scheme for the purposes mentioned herein above.

B) Facilities for Persons Other than Individuals-

The following remittances by persons other than individuals require prior approval of the Reserve Bank of India.

- i) Donations exceeding one per cent of their foreign exchange earnings during the previous three financial years or USD 5,000,000, whichever is less, for-
 - a) creation of Chairs in reputed educational institutes,
 - b) contribution to funds (not being an investment fund) promoted by educational institutes; and
 - c) contribution to a technical institution or body or association in the field of activity of the donor Company.
- ii) Commission, per transaction, to agents abroad for sale of residential flats or commercial plots in India exceeding USD 25,000 or five percent of the inward remittance whichever is more.
- iii) Remittances exceeding USD 10,000,000 per project for any consultancy services in respect of infrastructure projects and USD 1,000,000 per project, for other consultancy services procured from outside India.
- iv) Remittances exceeding five per cent of investment brought into India or USD 100,000 whichever is higher, by an entity in India by way of reimbursement of pre-incorporation expenses.

8.10 AUTHORISED PERSON

The authorized persons are the authorized dealers, money changers, off-shore banking units or may be called by any other name; who are authorized on behalf of the RBI to deal in foreign exchange or foreign securities.³⁷ The RBI shall authorize such person in writing and shall be subject to the conditions laid down by the RBI.³⁸ The RBI can also revoke the authorization at any time if the revocation is required to be done in public interest or the authorized dealer fails to comply with the condition subject to which authorisation was granted.³⁹ However, before revocation, the authorized dealer has to be given a reasonable opportunity of being heard.

Duties of Authorised Person

- 1) An authorised person shall, in all his dealings in foreign exchange or foreign security, comply with general or special directions/or orders of the Reserve Bank. Without the prior permission of the Reserve Bank, an authorised person shall not engage in any transaction involving any foreign exchange or foreign security which is not in conformity with the terms of his authorisation.⁴⁰
- 2) Before undertaking any transaction in foreign exchange on behalf of any person, the Authorised Person shall require that person to make such declaration and to give such information as will reasonably satisfy him that the transaction will not involve, and is not designed for the purpose of any contravention or evasion of the provisions of this Act or of any rule, regulation, notification, direction or order made thereunder. Where the said person refuses to comply with any such requirement or makes only unsatisfactory compliance therewith, the authorised person shall refuse in writing to undertake the transaction and shall, if he has reason to believe that any such contravention or evasion as aforesaid is contemplated by the person, report the matter to the Reserve Bank.⁴¹
- 3) The Reserve Bank may give any direction in regard to making of payment or the doing or desist from doing any act relating to foreign exchange or foreign security to the authorised persons.⁴²
- 4) The Reserve Bank may also direct any authorised person to furnish such information, in such manner, as it deems fit.⁴³ However, where any authorised person contravenes any direction given by the Reserve Bank under this Act or fails to file any return as directed by the Reserve Bank, the Reserve Bank may, after giving reasonable opportunity of being heard, impose on the authorised person a penalty which may extend to ten thousand rupees and in the case of continuing contravention with an additional penalty which may extend to two thousand rupees for every day during which such contravention continues.⁴⁴

The Reserve Bank also has the power to inspect the authorised persons by authorizing an officer on its behalf, for the purpose of –

- a) verifying the correctness of any statement, information or particulars furnished to the Reserve Bank;
- b) obtaining any information or particulars which such authorised person has failed to furnish on being called upon to do so;

- c) securing compliance with the provisions of this Act or of any rules, regulations, directions or orders made thereunder.

Every authorised person is under a duty to produce such books, accounts and other documents in his custody or power and to furnish any statement or information relating to the affairs of such personas may be required.⁴⁵

8.11 CONTRAVENTIONS & PENALTIES⁴⁶

If any person contravenes with the provisions of the Act, Rules, Regulations, notification, direction or order thereunder or contravenes any condition subject to which an authorization is issued by the RBI, the following penalties have been provided for under the Act:

- 1) Such a person shall, upon adjudication, be liable to a penalty up to thrice the sum involved in such contravention where such amount is quantifiable, or up to two lakh rupees where the amount is not quantifiable, and where such contravention is a continuing one, further penalty which may extend to five thousand rupees for every day after the first day during which the contravention continues.⁴⁷
- 2) If any person is found to have acquired any foreign exchange, foreign security or immovable property, situated outside India, of the aggregate value exceeding the threshold prescribed under the proviso to sub-section (1) of section 37A, he shall be liable to a penalty upto three times the sum involved in such contravention and confiscation of the value equivalent, situated in India, the foreign exchange, foreign security or immovable property.⁴⁸

If the Adjudicating Authority, deems fits, he may, after recording the reasons in writing, recommend for the initiation of prosecution. If the Director of Enforcement is satisfied, he may, after recording the reasons in writing, direct prosecution by filing a Criminal Complaint against the guilty person by an officer not below the rank of Assistant Director.⁴⁹

- 3) In addition to the penalty, such a person shall also be punishable with imprisonment for a term which may extend to five years and with fine.⁵⁰

The court cannot take cognizance of an offence under section 13 except as on complaint in writing by an officer not below the rank of Assistant Director.

- 4) An Adjudicating Authority, in addition to any for contravention, may also direct that any currency, security or any other money or property in respect of which the contravention has taken place shall be confiscated to the Central Government and further direct that the foreign exchange holdings, if any, of the persons committing the contraventions or any part thereof, shall be brought back into India or shall be retained outside India in accordance with the directions made in this behalf.⁵¹

Enforcement of the Order of the AA

Any person who fails to make full payment of the penalty imposed on him under the Act within a period of ninety days from the date on which the notice for payment of such penalty is served on him, is liable to civil imprisonment.⁵²

The Adjudicating Authority has been vested with the powers of issuing warrant of arrest and detention in the following circumstances-

- 1) An order for the arrest and detention in civil prison of a defaulter can be made⁵³-
 - i) When the Adjudicating Authority has issued and served a notice upon the defaulter calling upon him to appear before him on the date specified in the notice and to show cause why he should not be committed to the civil prison., and
 - ii) When the Adjudicating Authority, for reasons in writing, is satisfied—
 - a) that the defaulter, with the object or effect of obstructing the recovery of penalty, has, after the issue of notice, dishonestly transferred, concealed, or removed any part of his property, or
 - b) that the defaulter has, or has had since the issuing of notice, the means to pay the arrears or some substantial part thereof and refuses or neglects or has refused or neglected to pay the same.
- 2) A warrant for the arrest of the defaulter may be issued by the Adjudicating Authority, upon satisfaction by affidavit or otherwise, that the defaulter is likely to abscond or leave the local limits of the jurisdiction of the Adjudicating Authority.⁵⁴
- 3) Where appearance is not made pursuant to a notice issued and served, the Adjudicating Authority may issue a warrant for the arrest of the defaulter.⁵⁵
- 4) A warrant of arrest issued by the Adjudicating Authority may also be executed by any other Adjudicating Authority within whose jurisdiction the defaulter may for the time being be found.⁵⁶

The following provisions are also needed to be complied with:

- a) Every arrested person shall be brought before the Adjudicating Authority as soon as practicable and in any event within twenty-four hours of his arrest (exclusive of the time required for the journey). Provided that the defaulter shall be released at once, if he pays the amount entered in the warrant of arrest as due and the costs of the arrest to the officer arresting him.⁵⁷
- b) When a defaulter appears before the Adjudicating Authority, he shall be given an opportunity by the Adjudicating Authority showing cause why he should not be committed to the civil prison.
- c) Pending the conclusion of the inquiry, the defaulter can also be detained in the custody of such officer as the Adjudicating Authority may think fit. He can also be released on his furnishing the security to the satisfaction of the Adjudicating Authority for his appearance as and when required.
- d) Upon the conclusion of the inquiry, the Adjudicating Authority may make an order for the detention of the defaulter in the civil prison and shall in that event cause him to be arrested if he is not already under arrest. Provided that in order to give a defaulter an opportunity of satisfying the arrears, the Adjudicating Authority may, before making the order of detention, leave the defaulter in the custody of the officer arresting him or of any other officer for a specified period not exceeding fifteen days, or release him on his

furnishing security to the satisfaction of the Adjudicating Authority for his appearance at the expiration of the specified period if the arrears are not satisfied.

- e) The detention order may be executed at any place in India in the manner provided for the execution of warrant of arrest under the Code of Criminal Procedure, 1973.⁵⁸
- f) The Adjudicating Authority may, by order in writing, authorise an officer of Enforcement not below the rank of Assistant Director to recover any arrears of penalty from any person who fails to make full payment of penalty imposed on him within the period of ninety days from the date on which the notice for payment of such penalty is served on him.⁵⁹
- g) Any contravention may, on an application made by the person committing such contravention, be compounded within one hundred and eighty days from the date of receipt of application by the Director of Enforcement or such other officers of the Directorate of Enforcement and officers of the Reserve Bank as may be authorised in this behalf by the Central Government. Where a contravention is compounded, no proceeding or further proceeding, shall be initiated or continued, against the person committing such contravention under that section, in respect of the contravention so compounded.⁶⁰

8.12 PROVISION FOR APPEAL

The Act provides the provision for appeal in three stages-

- i) Appeal before the Special Director(Appeals) against the order of the Adjudicating Officer
- ii) Appeal before the Appellate Tribunal Against the Order of the Special Director
- iii) Appeal before the High Court

Appeal to the Special Director (Appeals)⁶¹

An appeal against the order of the Adjudicating Authority may be made to the Special Director (Appeals) appointed by the Central Government.⁶² Every appeal should be filed within forty-five days from the date on which the copy of the order made by the Adjudicating Authority is received by the aggrieved person. The Special Director (Appeals) may entertain an appeal after the expiry of the said period of forty-five days, if he is satisfied that there was sufficient cause for not filing it within that period.⁶³

Appeal before the Appellate Tribunal⁶⁴

The Central Government or any person aggrieved by an order made by an Adjudicating Authority, or the Special Director (Appeals), may prefer an appeal to the Appellate Tribunal. Any person appealing against the order of the Adjudicating Authority or the Special Director (Appeals) levying any penalty, is required while filing the appeal, to deposit the amount of such penalty with such authority as may be notified by the Central Government. However, if the Appellate Tribunal is of the opinion that the deposit of such penalty would cause undue hardship to such person, the Appellate Tribunal may dispense with such deposit

subject to such conditions as it may deem fit to impose so as to safeguard the realisation of penalty.

Every appeal before the Appellate Tribunal must be filed within a period of forty-five days from the date on which a copy of the order made by the Adjudicating Authority or the Special Director (Appeals) is received by the aggrieved person or by the Central Government. The Appellate Tribunal may entertain an appeal after the expiry of the said period of forty-five days if it is satisfied that there was sufficient cause for not filing it within that period.

Appeal before the High Court⁶⁵

Any person aggrieved by any decision or order of the Appellate Tribunal may file an appeal to the High Court within sixty days from the date of communication of the decision or order of the Appellate Tribunal to him on any question of law arising out of such order. The High Court may allow an appeal after the expiry of the said period for a further period not exceeding sixty days, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period., allow it to be filed within a further period not exceeding sixty days.

8.13 DIRECTORATE OF ENFORCEMENT

The Directorate of Enforcement is established under the Act by the Central Government. The Government appoints the Director and other officers who are together called the Officers of Enforcement.⁶⁶

Powers of Directorate of Enforcement-

The following powers are being vested in the Directorate of Enforcement and its officers:

- 1) *Power of search & Seizure⁶⁷*- The Director of Enforcement and other officers of Enforcement, not below the rank of an Assistant Director, can do investigation of the contraventions under the Act. The Central Government may also, by notification, authorise any officer or class of officers in the Central Government, State Government or the Reserve Bank, not below the rank of an Under Secretary to the Government of India to investigate any contravention under the Act. The officers are also vested with the like powers which are conferred on income-tax authorities under the Income-tax Act, 1961.
- 2) *Special provisions relating to assets held outside India in contravention of section 4-⁶⁸* If the Authorised Officer has reason to believe that any foreign exchange, foreign security, or any immovable property, situated outside India, is suspected to have been held in contravention of section 4, he may after recording the reasons in writing, by an order, seize value equivalent, situated within India, of such foreign exchange, foreign security or immovable property. No such seizure can be made in case where the aggregate value of such foreign exchange, foreign security or any immovable property, situated outside India, is less than the prescribed value.

8.14 COMPOUNDING OF OFFENCES UNDER FEMA

The Act allows for compounding for contraventions under section 15 of the Act. However, in this regard, the RBI has issued a Master Direction on Compounding of Contraventions under the FEMA 1999. According to the notification issued dated May 3, 2000 and FEMA 20(R)/2017-RB dated November 07, 2017, the power to compound contraventions has been delegated to the Regional offices/sub-offices of the Reserve Bank. In exercise of the powers conferred by section 46 read with sub-section (1) of section 15 of the Foreign Exchange Management Act, 1999, the relevant rules are the Foreign Exchange (Compounding Proceedings) Rules, 2000 made by the Central Government in this behalf. In terms of these Rules, the Reserve Bank is empowered to compound contraventions relating to Section 7, 8 and 9 and the third schedule to FEMCAT Rules. RBI was empowered to compound all the contraventions of FEMA 1999 except Section 3(a) of the Act.⁶⁹

The following contraventions can be compounded by the RBI where the sum involved in such contravention is:

- a) ten lakhs rupees or below, by the Assistant General Manager of the Reserve Bank of India;
- b) more than rupees ten lakhs but less than rupees forty lakhs, by the Deputy General Manager of Reserve Bank of India;
- c) rupees forty lakhs or more but less than rupees hundred lakhs by the General Manager of Reserve Bank of India;
- d) rupees one hundred lakhs or more, by the Chief General Manager of the Reserve Bank of India;

No contravention shall be compounded unless the amount involved in such contravention is quantifiable.

8.15 SUMMARY

The objective of formulating the FEMA Act 1999 was to consolidate the laws related to foreign exchange, facilitate the external trade & payments and to promote the orderly development and maintenance of foreign exchange market in India. It can be said that the Central Government and the RBI have been able to fulfil the broad objectives of FEMA. FEMA has been a reformatory legislation which has also been successful in eliminating the ills of its predecessor.

8.16 SELF ASSESSMENT QUESTIONS

- 1) Discuss the rights relating to immovable property of persons who are not resident in India.
- 2) What are the prohibited transactions under the FEMA?
- 3) What are the rights of persons who are alleged to have contravened provisions of the FEMA?
- 4) What do you understand by the term 'foreign exchange'?

- 5) Distinguish between the following:
- a) Person resident in India and Person Non-resident in India
 - b) Capital account transactions and current transactions

8.17 FURTHER READINGS/REFERENCES

Books:

- 1) R. Sridhar. R., 2019, FEMA Ready Reckoner with Commentary, Bloomsbury
- 2) Taxmann's Foreign Exchange Management (FEMA) Manual (2021)

References:

- ¹ The FEMA 1999
- ² Sec 2(v) FEMA Act 1999
- ³ Sec 2(w) FEMA Act 1999
- ⁴ Sec 2 (c) FEMA Act 1999
- ⁵ Sec 2(e), FEMA Act 1999
- ⁶ Sec 2(j), FEMA Act 1999
- ⁷ Sec 2(m), FEMA Act 1999
- ⁸ Sec 2 (n), FEMA Act 1999
- ⁹ Sec 11, FEMA Act 1999
- ¹⁰ Sec 3, FEMA Act 1999
- ¹¹ Sec 4, FEMA 1999
- ¹² Sec 6, FEMA 1999
- ¹³ Sec 2(e) FEMA 1999
- ¹⁴ Sec 6(2) FEMA 1999
- ¹⁵ Sec 6(2A) FEMA 1999
- ¹⁶ Sec 6(3) FEMA 1999
- ¹⁷ Sec 6(4)
- ¹⁸ Inserted by FEM (Acquisition and Transfer of Immovable Property Outside India) Regulations, 2015 with effect from January 21, 2016.
- ¹⁹ Sec 6(5)
- ²⁰ Inserted by FEM (Acquisition and transfer of Immovable Property in India) Regulations, 2018 with effect from March 26, 2018 through FEMA 21(R), dated 26.03.2018
- ²¹ ibid
- ²² ibid
- ²³ ibid
- ²⁴ ibid
- ²⁵ Sec 6(6)
- ²⁶ Reg 3(1) FEMA (Permissible Capital Account Transactions) Regulations 2000
- ²⁷ Regulation 3(2) FEMA (Permissible Capital Account Transactions) Regulations 2000
- ²⁸ Annexure
- ²⁹ Reg 4 FEMA (Permissible Capital Account Transactions) Regulations 2000

- 30 **ibid**
- 31 **Reg 5 FEMA (Permissible Capital Account Transactions) Regulations 2000**
- 32 **Reg 6 FEMA (Permissible Capital Account Transactions) Regulations 2000**
- 33 **Sect 2(j) FEMA 1999**
- 34 **Sec 5, FEMA 1999**
- 35 **Rule 2(b) Foreign Exchange Management (Current Account Transactions)
Rules, 2000**
- 36 **Rule 3 Foreign Exchange Management (Current Account Transactions) Rules,
2000**
- 37 **Sec 10 (1)**
- 38 **Sec 10(2)**
- 39 **Sec 10(3)**
- 40 **Sec 10(4)**
- 41 **Sec 10(5)**
- 42 **Sec 11(1)**
- 43 **Sec 11(2)**
- 44 **Sec 11(3)**
- 45 **Sec 12 (2)**
- 46 **Chapter IV FEMA 1999**
- 47 **Sec 13 (1)**
- 48 **Sec 13(1A)**
- 49 **Sec 13(1 B)**
- 50 **Sec 13(1 C)**
- 51 **Sec 13(2)**
- 52 **Sec 14**
- 53 **Sec 14(2)**
- 54 **Sec 14(3)**
- 55 **Sec 14(4)**
- 56 **Sec 14 (5)**
- 57 **Sec 14(6)**
- 58 **Sec 13(13)**
- 59 **Sec 14**
- 60 **Sec 15**
- 61 **Sec 17**
- 62 **Sec 17(1)**
- 63 **Sec 17(3)**
- 64 **Sec 19**
- 65 **Sec 35**
- 66 **Sec 36 (1)**
- 67 **Sec 37**
- 68 **Sec 37 A**
- 69 **Vide GSR 609 (E) dated 13-09-2004**

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UNIT 9 INSOLVENCY AND BANKRUPTCY

Objectives

After studying this unit, you should be able to:

- Understand the basics of Insolvency Law & Practice.
- Describe the legal and regulatory system relating to distress or insolvency resolution in India prior to the enactment of the IBC.
- Explain the essential segments of the Corporate Insolvency under the Insolvency and Bankruptcy Code, 2016
- Discuss different aspects relating to individual bankruptcy, and liquidation of insolvent companies.

Structure

- 9.1 Introduction
- 9.2 Definition of 'Insolvency'
- 9.3 Corporate Insolvency Legislative Framework in India Prior to 2016
- 9.4 Unified Insolvency and Bankruptcy Law - The Insolvency and Bankruptcy Code, 2016
- 9.5 Four Pillars of Institutional Infrastructure under IBC 2016
- 9.6 Corporate Insolvency Resolution Process
- 9.7 Liquidation Process under IBC 2016
- 9.8 Individual Insolvency
- 9.9 Cross Border Insolvency
- 9.10 Leading Cases
- 9.11 Summary
- 9.12 Self Assessment Questions
- 9.13 Further Readings/References

9.1 INTRODUCTION

This Unit explains the law and mechanism related to corporate insolvency resolution process for corporates in India. The Unit commences describing the legal and regulatory situation in place prior to enacting of the Insolvency and Bankruptcy Code 2016. It further examines the need to adopt the Insolvency and Bankruptcy Code, 2016 (hereinafter referred to as IBC or the Code). It discusses the salient aspects of the Code with the help of leading cases.

An effective and efficient insolvency regime should aim to achieve the key objectives which are identified below in a balanced manner:

- Provide certainty in the market to promote economic stability and growth;
- Maximize value of assets;
- Strike a balance between liquidation and reorganization;
- Ensure equitable treatment of similarly situated creditors;
- Provide for timely, efficient and impartial resolution of insolvency;

9.2 DEFINITION OF INSOLVENCY

The United Nations Commission on International Trade Law (UNCITRAL), Legislative Guide on Insolvency Law” defines ‘insolvency’ as;

“Insolvency is when a debtor is generally unable to pay its debts as they mature or when its liabilities exceed the value of its assets”

In the context of the UK Insolvency Act, 1986, the renowned author, Sir Roy Goode observed;

“A company is insolvent when it is unable to pay its debts. The concept is simple enough but as we shall see there is more than one test of inability to pay debts and in marginal cases it may be far from easy to determine whether the test is satisfied as at the relevant time. Insolvency as such is not a condition to which legal consequences attach. These occur only after there has been some formal proceeding, such as winding up or the appointment of an administrator or administrative receiver. Thus it is neither a criminal offence nor a civil wrong for a company to become insolvent or even to trade while insolvent.”¹

The Oxford dictionary defines word insolvent as,

“Not having enough money to pay debt, creditors, etc.; belonging or relating to insolvent people; or the state of being insolvent”²

Surprisingly, unlike the international laws, the Code does not define ‘insolvency’ in explicit terms. However, ‘default’ by the corporate debtor has been marked as a trigger for initiating the insolvency proceedings. The Bankruptcy Law Reform Committee Report (BLRC Report) explains in following terms:

- *Financial failure - a persistent mismatch between payments by the enterprise and receivables into the enterprise, even though the business model is generating revenues,*
- *Business failure - which is a breakdown in the business model of the enterprise, and it is unable to generate sufficient revenues to meet payments³.*

9.3 CORPORATE INSOLVENCY LEGISLATIVE FRAMEWORK IN INDIA PRIOR TO 2016

India had a patchwork of insolvency courts and tribunals applying to different classes of stakeholders or processes which resulted in parallel proceedings, conflicts between different statutes and uncertainty for creditors over their recovery. The conflicts and multiple proceedings that have arisen from the multi-layered Insolvency law framework pointed towards a strong need for a unified bankruptcy code that could be applicable to all aspects of a company in distress and for all stakeholders. The complex web of laws which till recent past governed corporate bankruptcy and insolvency included:

- **Companies Act, 2013 (CA 2013)** – This Act contains provisions on collective insolvency resolution by way of restructuring, rehabilitation, or reorganization of entities registered under the Act. Adjudication Authority is the National Company Law Tribunal (NCLT). CA 2013 contains provisions for rescue and rehabilitation of all registered entities in Chapter XIX, and Liquidation in Chapter XX.

- **Companies Act, 1956 (CA, 1956)** – This legislation deals with winding up of companies. There is however no separate provisions for restructuring except through Mergers & Acquisitions (M&As) and voluntary compromise. Adjudication authority is the High Court.
- **Sick Industrial Companies Act, 1985 (SICA, 1985)** – This Act dealt with restructuring of distressed ‘industrial’ firms. Under this Act, the Board for Industrial and Financial Reconstruction (BIFR) assessed the viability of the industrial company, and referred an unviable company to the High Court for liquidation. SICA, 1985 contained special provisions for timely detection of sick industrial companies and for undertaking preventative, ameliorative, remedial and other measures in respect of such companies.
- **The Recovery of Debt Due to Banks and Financial Institutions Act, 1993 (RDDBFIA, 1993)** – This Act gives banks and a specified set of financial institutions greater powers to recover collateral at default. The law provides for the establishment of special Debt Recovery Tribunals (DRTs) to enforce debt recovery by these institutions only. The law also provides for the Debt Recovery Appellate Tribunals (DRATs) as the appellate forum.
- **The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI, 2002)** – This Act enables secured creditors to take possession of collateral without requiring the involvement of a court or tribunal. This law provides for actions by secured creditors to take precedence over a reference by a debtor to BIFR. The DRT is the forum for appeals against such recovery.

Issues relating to various legislations dealing with Corporate Insolvency and Restructuring;

- **SICA:** Under the SICA industrial companies whose network has eroded by 100% are identified as being in distress and are referenced to the BIFR. Thereafter the BIFR must investigate the potential viability of the industrial company and then either recommend its rehabilitation scheme or winding up before the High Court.

Major issues with the legislation are:

- * **Delay:** Under SICA provisions 5 to 7 years are required for reviving a company⁴. Out of which around 3 to 4 years are required just to decide whether a particular company needs rehabilitation or liquidation.

Delays further contribute to other issues such as debtors using the delay to defer payments to the creditors because of the moratorium that is placed upon creditor enforcement, corporate assets being siphoned off during the long drawn process, managers coercing creditors into extending further finance or giving concessions in existing debts. It has been observed that SICA is capable of achieving a swift liquidation only where creditors rejected possibility of revival.

- * **Improper identification of companies that can be restructured:** It has been repeatedly stated that the BIFR has failed to satisfactorily identify companies capable of restructuring or have sanctioned schemes which have severely hampered the creditors’ interests.

* **SICA does not assist the creditor:** In many cases where the creditors seek liquidation the cases have been sent back to the BIFR to conduct inquiry into rehabilitation.

- **SARFAESI:** The Act provides mechanism to the secured creditor to take possession of the property of the debtor without intervention by the Courts or Tribunals. Appeals against such possession may be made to the DRT.
- **RDDBI:** This Act focuses specifically on the easing recovery for banks and other financial institutions both secured and unsecured creditors. The Act additionally provided for the establishment of DRTs and DRATs.

9.4 UNIFIED INSOLVENCY AND BANKRUPTCY LAW - THE INSOLVENCY AND BANKRUPTCY CODE, 2016

As mentioned above a host of legislation and forum combined with potentially conflicting jurisdictional issues had resulted in systemic delays and complexities in the insolvency and bankruptcy process. Additionally, all these legislations have been identified as being inadequate in by themselves. Thus the Insolvency and Bankruptcy Code, 2016 (hereinafter referred to as IBC or the Code) was enacted. This Code aims to consolidate the laws relating to insolvency of companies and limited liability entities (including limited liability partnerships and other entities with limited liability), unlimited liability partnerships and individuals, presently contained in a number of legislations, into a single legislation. Such consolidation will provide for a greater clarity in law and facilitate the application of consistent and coherent provisions to different stakeholders affected by business failure or inability to pay debt.

“An effective insolvency regime is a critical component of ease of doing business in India”.

This Code is considered as the biggest economic reform next only to GST⁵. The insolvency regime is expected not only to facilitate an easy revival and rehabilitation process for companies in financial trouble but also to be very effective in safeguarding the interests of the stakeholders such as creditors, shareholders, government, etc. It is also expected to stabilize the commercial dealings, financial stability and better environment for attracting investments, besides mitigation of corporate failures. Further, it should also ensure that the financial resources of a country are utilized efficiently to enhance the overall growth of the economy.

Salient features of IBC 2016

The salient features of the IBC 2016 are as follows:

- Clear, coherent and speedy process for early identification of financial distress and resolution of companies and limited liability entities if the underlying business is found to be viable.
- Two distinct processes for resolution of individuals, namely- “Fresh Start” and “Insolvency Resolution”.
- Debt Recovery Tribunal and National Company Law Tribunal to act as

Adjudicating Authority and deal with the cases related to insolvency, liquidation and bankruptcy process in respect of individuals and unlimited partnership firms, and in respect of companies and limited liabilities entities respectively.

- Establishment of an Insolvency and Bankruptcy Board of India to exercise regulatory oversight over insolvency professionals, insolvency professional agencies and information utilities.
- Insolvency professionals would handle the commercial aspects of insolvency resolution process. Insolvency professional agencies will develop professional standards, code of ethics and be first level regulator for insolvency professionals leading to development of a competitive industry for such professionals.
- Information utilities would collect, collate, authenticate and disseminate financial information to be used in insolvency, liquidation and bankruptcy proceedings.
- Enabling provisions to deal with cross border insolvency.

9.5 FOUR PILLARS OF INSTITUTIONAL INFRASTRUCTURE UNDER IBC 2016

There exist four pillars of institutional infrastructure created by the IBC 2016. These are as follows:

1. Insolvency Professionals and Insolvency Professionals Agencies:

The first pillar of institutional infrastructure is a class of regulated persons, the Insolvency Professionals. They play a key role in the efficient working of the bankruptcy process and are regulated by Insolvency Professional Agencies.

An Insolvency Professional (IP) plays a central role in the effective and efficient implementation of an insolvency law, with certain powers over debtors and their assets and a duty to protect those assets and their value, as well as the interests of creditors and employees, and to ensure that the law is applied effectively and impartially.

An IP may hold any of the following roles under the Code:

- Resolution professional (RP)** to resolve insolvency for a firm or an individual;
- Bankruptcy Trustee** in an individual bankruptcy process;
- Liquidator** in a firm liquidation process;

Who can be Insolvency Professional under IBC, 2016?

Regulation 5 of the Insolvency and Bankruptcy Board of India (Insolvency Professionals) Regulations, 2016⁶, provides the following qualifications and experience to become an “Insolvency professional”:

Subject to the other provisions of these Regulations, an individual shall be eligible for registration, if he;

- a) has passed the National Insolvency Examination;
- b) has passed the Limited Insolvency Examination, and has fifteen years of experience in management, after he received a Bachelor's degree from a university established or recognized by law; or
- c) has passed the Limited Insolvency Examination and has **ten years** of experience as -
 - i) a chartered accountant enrolled as a member of Institute of Chartered Accountants of India,
 - ii) a company secretary enrolled as a member of Institute of Company Secretaries of India,
 - iii) a cost accountant enrolled as a member of the Institute of Cost Accountants of India, or
 - iv) an advocate enrolled with a Bar Council.

2) Information Utilities

The second pillar of institutional infrastructure is a new industry of 'Information Utilities'. These are service providers which are required to store facts about lenders and terms of lending in electronic databases. This is intended to eliminate delays and disputes about facts when default takes place. Chapter V of Part IV of the IBC contains provisions with respect to Information Utilities⁷. An information utility is contemplated as a registered service provider, which shall be obliged to⁸:

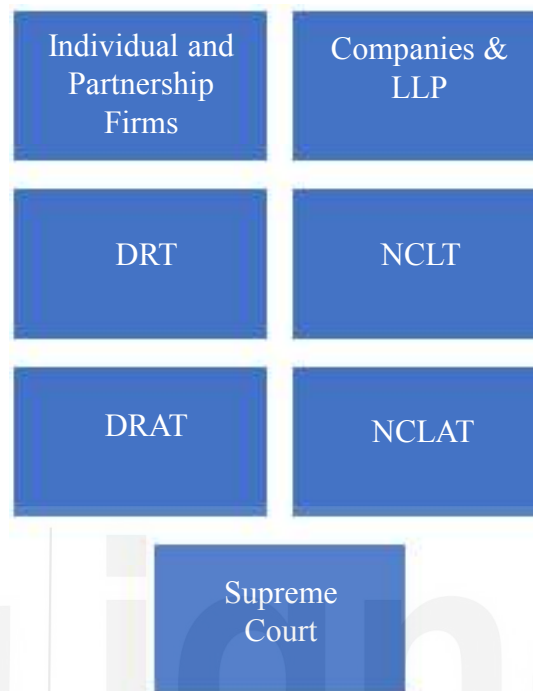
- Create and store financial information in a universally accessible format;
- Accept electronic submissions of financial information from persons who are under obligations to submit financial information under the CODE, in such form and manner as may be specified by regulations;
- Accept, in specified form and manner, electronic submissions of financial information from persons who intend to submit such information;
- Meet such minimum service quality standards as may be specified by regulations;
- Get the information received from various persons authenticated by all concerned parties before storing such information;
- Provide access to the financial information stored by it to any person who intends to access such information in such manner as may be specified by regulations;
- Publish such statistical information as may be specified by regulations;
- Have inter-operability with other information utilities.

Any person who intends to submit financial information to the information utility or access the information from the information utility shall pay such fee and submit information in such form and manner as may be specified by regulations⁹.

3) Adjudication

The third pillar of institutional infrastructure are the adjudication authorities. The National Company Law Tribunal (NCLT) is the forum where insolvency

of corporate persons will be heard and DRT is the forum where individual insolvencies will be heard. These institutions, along with their Appellate bodies, viz., NCLAT and DRATs will be adequately strengthened so as to achieve world class functioning of the bankruptcy process.



i) **Adjudicator for Corporate Insolvency and Bankruptcy- National Company Law Tribunal**

The Adjudicating Authority, in relation to insolvency resolution and liquidation for corporate persons including corporate debtors and personal guarantors thereof shall be the National Company Law Tribunal.

Territorial jurisdiction

The NCLT will have territorial jurisdiction over the place where the registered office of the corporate person is located¹⁰. The NCLT, before which a corporate insolvency resolution process or liquidation proceeding of a corporate debtor is pending, will also have jurisdiction in the matter of the insolvency resolution or bankruptcy of a personal guarantor of such corporate debtor¹¹.

An insolvency resolution process or bankruptcy proceeding of a personal guarantor of the corporate debtor pending in any court or tribunal shall stand transferred to the NCLT dealing with insolvency resolution process or liquidation proceeding of such corporate debtor.

The NCLT is vested with all the powers of the Debt Recovery Tribunal and shall have jurisdiction to entertain or dispose of;

- Any application or proceeding by or against the corporate debtor or corporate person;
- Any claim made by or against the corporate debtor or corporate person, including claims by or against any of its subsidiaries situated in India; and
- Any question of priorities or any question of law or facts, arising out of or in relation to the insolvency resolution or liquidation proceedings of the corporate debtor or corporate person under the Code.

Civil court not to have jurisdiction

No civil court or authority has jurisdiction to entertain any suit or proceedings in respect of any matter on which NCLT or the National Company Law Appellate Tribunal has jurisdiction under this Code¹². No court, tribunal or authority shall grant an injunction in respect of any action taken, or to be taken, in pursuance of any power conferred on the NCLT or the National Company Law Appellate Tribunal under the Code.

ii) Adjudicator for Insolvency Resolution and Bankruptcy of Individuals & Partnerships- Debt Recovery Tribunal (DRT)¹³

The Adjudicating Authority, in relation to insolvency matters of individuals and firms shall be the Debt Recovery Tribunal, having territorial jurisdiction over the place where the individual debtor actually and voluntarily resides or carries on business or personally works for gain and can entertain an application under this Code regarding such person.

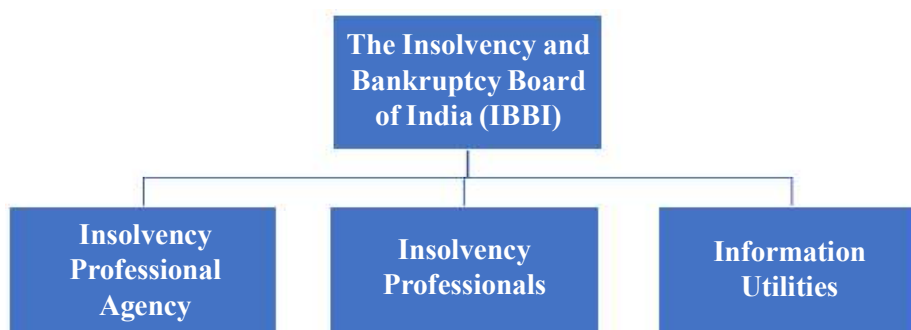
The Debt Recovery Tribunal shall have jurisdiction to entertain or dispose of:

- any suit or proceeding by or against the individual debtor;
- any claim made by or against the individual debtor;
- any question of priorities or any other question whether of law or facts, arising out of or in relation to insolvency and bankruptcy of the individual debtor or firm under this Code.

An appeal from an order of the Debt Recovery Tribunal under this Code shall be filed within thirty days before the Debt Recovery Appellate Tribunal (DRAT). An appeal from an order of the Debt Recovery Appellate Tribunal on a question of law under this Code shall be filed within forty-five days before the Supreme Court.

4) The Insolvency and Bankruptcy Board of India (IBBI)

The fourth pillar of institutional infrastructure is the regulator, *the Insolvency and Bankruptcy Board of India* (hereinafter referred to as the Board or IBBI) with head office in the National Capital Region and offices at other places in India.¹⁴ The central government has the power to designate a financial sector regulator to perform the functions till such time the Board is constituted. Until the Board is constituted or a financial sector regulator is designated under Section 195, as the case may be, the powers and functions of the Board or such designated financial sector regulator, including its power to make regulations, shall be exercised by the Central Government.¹⁵



Constitution of Board and selection of Members

The Board shall consist of the following Members to be appointed by the Central Government, who shall appoint them (other than the *ex officio* members) after obtaining the recommendation of a selection committee. The Board consists of:

- Chairperson;
- Three *ex-officio* Members from amongst the officers of the Central Government not below the rank of Joint Secretary or equivalent, one each to represent the Ministry of Finance, the Ministry of Corporate Affairs and Ministry of Law;
- One *ex-officio* Member to be nominated by the Reserve Bank of India; and
- Five other Members to be nominated by the Central Government, of whom at least three shall be the whole-time members.

The tenure of the office bearers is given in Section 189(4) of the IBC 2016. The term of office of all the members (except *ex officio* members) shall be for a period of 5 years or until they attain the age of 65, whichever is earlier. They are eligible for re-appointment as well.

Objectives of the Board:

The objective of the Board is to utilize all legislative, executive and quasi-judicial functions so as to achieve a well-functioning bankruptcy process in India. This would include features of:

- High recovery rates in an NPV sense;
- Low delays from start to end;
- Sound coverage of the widest possible class of claims e.g., bank loans, corporate bonds, etc.;
- A perception in the minds of persons in the economy that India has a swift and competent bankruptcy process.

9.6 CORPORATE INSOLVENCY RESOLUTION PROCESS

Trigger point for initiation

A corporate insolvency resolution process may be initiated under Chapter II of the Code in respect of a corporate debtor that has committed a default. The trigger point for initiating the corporate insolvency resolution process is the occurrence of default. A default¹⁶ would have occurred when the debtor fails to pay whole or any part or installment of the amount of debt that has become due and payable. The “debt”¹⁷ has been defined under Code as a liability or obligation in respect of a claim, which is due from any person and includes a financial debt and operational debt. While a financial creditor is required to present record of default before NCLT for initiation of corporate insolvency resolution process, an operational creditor must issue a statutory notice to corporate debtor in the manner provided in Code.

The “claim”¹⁸, financial debt” and “operation debt” are defined in Code. A “claim” means **(a)** a right to payment, whether or not such right is reduced to judgment, fixed, disputed, undisputed, legal, equitable, secured, or unsecured; **(b)** right to

remedy for breach of contract under any law for the time being in force, if such breach gives rise to a right to payment, whether or not such right is reduced to judgment, fixed, matured, unmatured, disputed, undisputed, secured or unsecured. The corresponding obligation of the debtor to pay may arise out of a financial debt or an operational debt.

Who can initiate the process?

The process for initiating corporate insolvency resolution may be initiated by any of the following:

- A financial creditor¹⁹
- An operational creditor²⁰ or
- The corporate debtor²¹ itself

Commencement by financial creditor

Application by financial creditor

A financial creditor may initiate the process either by itself or jointly with other financial creditors by filing an application before the NCLT, if a default has occurred in respect of a financial debt owed not only to the applicant financial creditor but to any other financial creditor of the corporate debtor. A financial creditor is a person to whom a financial debt is owed and includes a person to whom such debt has been legally assigned or transferred to.

Ascertaining existence of debt default by NCLT

Within 14 days of receipt of application by NCLT²², it must ascertain the existence of a default from the records of an information utility or on the basis of other evidence furnished by the financial creditor. If NCLT is satisfied that (i) a default has occurred; or (ii) the application made by financial creditor is complete; or (iii) there is no disciplinary proceedings pending against the proposed resolution professional, it may, by order, admit such application. Under SICA, admission of reference made to BIFR was by way of an administrative act of registration of reference by the registry of BIFR. Now, an order must be passed by NCLT. It appears that the corporate debtor need not be heard by NCLT while ascertaining the existence of default.

The NCLT can reject the application if it finds that default has not occurred or the application made by financial creditor is incomplete or any disciplinary proceeding is pending against the proposed resolution professional. The NCLT is required to provide an opportunity to the applicant to rectify the defect in the application if the NCLT finds the application to be defective. The applicant must rectify the defect in his application within 7 days of receipt of such notice from the Adjudicating Authority.

Date of commencement

The corporate insolvency resolution process shall commence from the date of admission of the application of financial creditor by the NCLT. Order of admission of such application shall be communicated by the NCLT to the applicant and corporate debtor, and of rejection to the financial creditor, within seven days.

Declaration of moratorium and public announcement²³

With regard to creditors, one of the fundamental principles of insolvency law is that insolvency proceedings are collective proceedings, which require the interests of all creditors to be protected against individual action by one of them. Many insolvency laws include a mechanism to protect the value of the insolvency estate that not only prevents creditors from commencing actions to enforce their rights through legal remedies during some or all of the period of the liquidation or reorganization proceedings, but also suspends actions already under way against the debtor. Such a mechanism is variously termed a “moratorium”, “suspension” or “stay”, depending on the effect of the mechanism.

The Code provides for a moratorium from creditors action against the corporate debtor. Where the NCLT passes an order of admission of an application for commencement of corporate resolution process, the NCLT shall, by an order:

- Grant a moratorium mentioned in section 14.
- Appoint an interim resolution professional in the manner as laid down section 16 of the Code.
- Cause a public announcement of the initiation of corporate insolvency resolution process and call for the submission of claims immediately after the appointment of the interim resolution professional.

Moratorium

The order to declare moratorium prohibits:

- the institution of suits or continuation of pending suits or proceedings against the corporate debtor including execution of any judgement, decree or order in any court of law, tribunal, arbitration panel or other authority
- Transferring, encumbering, alienating or disposing of by the corporate debtor any of its assets or any legal right or beneficial interest therein
- Any action to foreclose, recover or enforce any security interest created by the corporate debtor in respect of its property including any action under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002
- The recovery of any property by an owner or lessor where such property is occupied by or in the possession of the corporate debtor

Exclusion from moratorium

The order of moratorium should not affect supply of essential goods or services to the corporate debtor, which shall not be terminated or suspended or interrupted during moratorium period. This is important to explore resolution of the corporate debtor as a going concern.

Conduct of corporate resolution process by resolution professional

The resolution professional is responsible for the conduct of the entire corporate insolvency resolution process and manage the operations of the corporate debtor during the corporate insolvency resolution process period. For this purpose, the resolution professional has the same powers and must perform same duties as vested or conferred on the interim resolution professional.

A resolution applicant may submit a resolution plan to the resolution professional prepared on the basis of the information memorandum²⁵. A resolution plan means a plan proposed by any person for insolvency resolution of the corporate debtor as a going concern in accordance with Part II of the Code. As already mentioned, a resolution applicant means any person who submits a resolution plan to the resolution professional. The resolution professional shall examine each resolution plan received by him to confirm that each resolution plan is compliant of the specifications provided in the Code.

Approval of resolution plan by creditors

A resolution plan, which confirms the conditions referred above, must be placed before the committee of creditors by the resolution professional for its approval. The committee of creditors may approve a resolution plan by a vote of not less than seventy five per cent of voting share of the financial creditors. The resolution applicant may attend the meeting of the committee of creditors in which the resolution plan of the applicant is considered. However, the resolution applicant shall not have a right to vote at the meeting of the committee of creditors unless such resolution applicant is also a financial creditor.

Approval of plan by NCLT

The resolution plan as approved by the committee of creditors must be presented by resolution professional to the NCLT for approval. If the NCLT is satisfied that the resolution plan as approved by the committee of creditors meets the requirements of resolution plan referred above (sub-section (2) of section 30), it shall, by order, approve the resolution plan. The resolution plan approved by the NCLT shall be binding on the corporate debtor and its employees, members, creditors, guarantors and other stakeholders involved in the resolution plan. As a consequence of the order of approval, the moratorium order passed by NCLT shall cease to have effect. Following the order of approval of resolution plan by the NCLT, the resolution professional shall forward all records relating to the conduct of the corporate insolvency resolution process and the resolution plan to the Board to be recorded on its database.

Rejection of resolution plan

If the NCLT is satisfied that the resolution plan does not confirm to the requirements (of sub-section (2) of section 30), it may, by an order, reject the resolution plan.

Punishment for contravention of resolution plan

If a corporate debtor, any of its officers or creditors or any person on whom the approved resolution plan is binding under section 31, knowingly and willfully contravenes any of the terms of such resolution plan or abets such contravention, such corporate debtor, officer, creditor or person shall be punishable with imprisonment of not less than one year, but may extend to five years, or with fine which shall not be less than one lakh rupees, but may extend to one crore rupees, or with both.

Time limit for completion of insolvency resolution process²⁶

The corporate insolvency resolution process provided in Chapter II must be completed within a period of 180 days from the date of admission of the

application to initiate such process (effective date). The period of 180 days can be extended by NCLT upto a maximum period of 90 days. Therefore, the total period for resolution of corporate insolvency, including extended period, can be upto a maximum of 270 days. An extension can be granted by the NCLT on an application filed by the resolution professional only if instructed to do so by a resolution passed at a meeting of the committee of creditors by a vote of seventy-five percent of the voting shares, and if it is satisfied that the subject matter of the case is such that corporate insolvency resolution process cannot be completed within 180 days. Any extension of the period of corporate insolvency resolution process cannot be granted more than once.

Appeal before National Company Law Appellate Tribunal

An appeal by a person aggrieved by an order approving the resolution plan by the NCLT may be filed before National Company Law Appellate Tribunal (hereinafter referred to as NCLAT) on the following grounds:

- The approved resolution plan is in contravention of the provisions of any law for the time being in force;
- There has been material irregularity in exercise of the powers by the resolution professional during the corporate insolvency resolution period;
- The debts owed to operational creditors of the corporate debtor have not been provided for in the resolution plan in the manner specified by the Board;
- The insolvency resolution process costs have not been provided for repayment in priority to all other debts; or
- The resolution plan does not comply with any other criteria specified by the Board.

Every such appeal shall be filed within 30 days. The NCLAT may allow an appeal to be filed after the expiry of the said period of 30 days if it is satisfied that there was sufficient cause for not filing the appeal but such period shall not exceed 15 days.

Appeal before Supreme Court of India

Any person aggrieved by an order of the NCLAT may file an appeal to the Supreme Court on a question of law arising out of such order under Code within 45 days from the date of receipt of such order. The Supreme Court may, if it is satisfied that a person was prevented by sufficient cause from filing an appeal within 45 days, allow the appeal to be filed within a further period not exceeding 15 days.

Fast track corporate insolvency resolution process²⁷

The Code provides for a fast-track corporate insolvency resolution process to be completed within a period of ninety days from the insolvency commencement date. The period of 90 days may be extended by a maximum period of 45 days by the NCLT on an application filed by resolution professional. The resolution professional can make such application for extension if instructed to do so by a resolution passed at a meeting of the committee of creditors and supported by a vote of seventy five percent of the voting share. Any extension of the fast-track corporate insolvency resolution process can be granted by the NCLT only once.

9.7 LIQUIDATION PROCESS UNDER IBC 2016

Commencement

Liquidation order under this Code is passed only where the corporate insolvency resolution and no resolution plan can be passed within the time provided or a resolution plan passed is not complied with. Liquidation in other cases or other grounds is dealt as proceedings for winding up under the Companies Act, 2013.

Grounds for passing order of liquidation of corporate debtor by the NCLT

An order of liquidation is to be passed by the NCLT in the following circumstances²⁸:

- If before the expiry of the insolvency resolution process period a resolution plan is not received for approval by the NCLT.
- If it rejects the resolution plan for the non-compliance of the requirements²⁹ specified.
- If the committee of creditors decides to liquidate the corporate debtor at any time during the corporate insolvency resolution process (but before confirmation of resolution plan by the NCLT), and an application is filed by the resolution professional to pass an order to liquidate the corporate debtor.
- If the corporate debtor contravenes the resolution plan approved by the NCLT, any person, whose interests are prejudicially affected by such contravention, can file a liquidation application.

Public announcement

Where an order of liquidation is passed by the NCLT, a public announcement stating that the corporate debtor is in liquidation must be issued. The NCLT shall also require such order to be sent to the authority with which the corporate debtor is registered. Protection of all interested persons is linked to publicity requirements, designed to apprise potentially interested persons that liquidation order has been passed.

9.8 INDIVIDUAL INSOLVENCY

The Insolvency and Bankruptcy Code, 2016, in its Part III provides for insolvency resolution and bankruptcy for individual and partnership firms.

The significant features of Part III are as follows:

- There exist two distinct processes in case of insolvencies: automatic fresh start and insolvency resolution.
- The code applies in all cases where the minimum default amount is Rs. 1000 and above.
- The insolvency resolution process consists of preparation of a repayment plan by the debtor, for approval of creditors. If approved, the DRT passes an order binding the debtor and creditors to the repayment plan. If the plan is rejected or fails, the debtor or creditors may apply for a bankruptcy order.

- The creditors and the debtor are required to agree on repayment plan for restructuring debts and affairs of the debtor under the supervision of an IP. Such a repayment plan requires approval of 75% of the financial creditors.
- The code prescribes a timeline of 180 days for the insolvency resolution process.³⁰

Fresh Start Process³¹

Under the automatic fresh start process, eligible debtors (basis gross income) can apply to the Debt Recovery Tribunal (DRT) for discharge from certain debts not exceeding a specified threshold, allowing them to start afresh. Under this, an application may be made by eligible debtor for any debt (other than secured debt, which has been availed of 3 months prior to the date of application, 'excluded debt').

Eligibility for a fresh start process application under the code are: (i) applicant should not own a dwelling unit and has a gross annual income of less than Rs. 60,000/-, with assets of value not exceeding Rs. 20,000/-, and (ii) aggregate value of the qualifying debt of such individual or partnership firm should not exceed Rs. 35,000/-. In addition, the applicant should not be an un-discharged insolvent and there be no other previous fresh start process applications submitted by him.

Discharge Order and its effects

The bankruptcy trustee should apply to the Adjudicating Authority for a discharge order either on the expiry of one year from the bankruptcy commencement date, or within seven days of the approval of the committee of creditors of the completion of administration of the estates of the bankrupt. The discharge order releases the bankrupt from all the bankruptcy debt.

However, a discharge order will not be granted if the discharge:

- Affects the functions of the bankruptcy trustee; or
- affects the operation of the provisions of Chapters IV and V of Part III; or
- releases the bankrupt from any debt incurred by means of fraud or breach of trust to which he was a party; or
- discharges the bankrupt from any excluded debt

Disqualifications Provisions

On the bankruptcy commencement date, the bankrupt is disqualified from:

- Appointment or acting as a trustee or representative in respect of any trust, estate or settlement;
- Appointment or acting as a public servant;
- Election to any public office;
- Election as a member of any local authority

9.9 CROSS BORDER INSOLVENCY

Cross border insolvency arrangement with other countries:³²

Sections 234 and 235 of the Code deals with cross border insolvency.

The Central Government may enter into an agreement with the government of any country outside India for enforcing the provisions of the Code. The Central Government may, by notification in the official gazette, direct that the application of provisions of the Code in relation to assets or property of corporate debtor or debtor, including a personal guarantor of a corporate debtor, as the case may be, situated at any place in a country outside India with which reciprocal arrangements have been made, shall be subject to such conditions as may be specified.

Letter of request to a country

If, in the course of insolvency resolution process, or liquidation or bankruptcy proceedings, as the case may be, the resolution professional, liquidator or bankruptcy trustee, as the case may be, is of the opinion that assets of the corporate debtor or debtor, including a personal guarantor of a corporate debtor, are situated in a country outside India with which reciprocal arrangements have been made under section 234, he may make an application to the NCLT or DRT as the case may be, that evidence or action relating to such assets is required in connection with such process or proceeding. On receipt of such an application the NCLT may issue a letter of request to a court or an authority of such country competent to deal with such request.

9.10 LEADING CASES

Some important cases on IBC are:

1) Innoventive Industries Ltd. Vs ICICI Bank Ltd. (Supreme Court CA No. 8337-8338 of 2017)

The Hon'ble Supreme Court held that in the event of any repugnancy between any State law and the Code, in respect of matters related to Insolvency & Bankruptcy, the Code would prevail over such State laws.

2) IDBI Bank Ltd. V. Lanco Infratech (CP (LB) No. 111/7 HDB/2017)

In this case the NCLT denied appointment of Interim Resolution Professional (IRP) on the ground that he was already handling three big assignments and had recently been appointed IRP for two large companies.

3) Lokhandwala Kataria Cons. Pvt. Ltd. Vs. Nisus Finance & Investment Managers LLP., (Supreme Court CA No. 9279 of 2017)

The Hon'ble Supreme Court, in exercise of its inherent power to ensure justice under Art.142, allowed the parties to withdraw the insolvency application upon the undertaking of the appellant to pay the outstanding dues to the applicant as per the consent terms.

4) Surendra Trading Co. vs. Juggilal Kamlapat Jute Mills Co. Ltd., (Supreme Court CA No. 8400 of 2017)

The issues for consideration by the Supreme Court were with regards to relaxation of time period prescribed under IBC

- Whether the time period of 14 days for admitting or rejecting an application by NCLT is directory or mandatory?

The NCLAT held that that such time period is directory in nature.

- Whether the time limit of 7 days prescribed under the Code for rectifying or removing defects in the application filed by an operational creditor for initiating CIRP is mandatory?

The Supreme Court observing that in a given case there might be weighty, valid and justifiable reasons for not able to remove defects within 7 days, held this to be merely a directory provision.

5) Mobilox Innovations Private Ltd vs Kirusa Software Pvt. Ltd., (Supreme Court C.A. No. 9405 of 2017)

The Supreme Court held that while examining admissibility of an Application u/s 9 of IBC, the NCLT will have to determine the three conditions mentioned under section 5(6). It was held that the definition of the term ‘dispute’ is an inclusive one and the present case was not one where suit or arbitration proceeding had been filed before receipt of demand notice, only in which case the dispute must relate to the three sub clauses of section 5(6).

6) Arun Kumar Jagatramka v. Jindal Steel and Power Ltd., (2021 SCC OnLine SC 220)

The Supreme Court decided on 15th March 2021 that a person who is ineligible under Section 29A of the Insolvency Bankruptcy Code, 2016, to submit a resolution plan, is also barred from proposing a scheme of compromise and arrangement under Section 230 of the Companies Act, 2013.

7) Kalparaj Dharamshi v. Kotak Investment Advisors Ltd, (2021 SCC OnLine SC 204)

The Supreme Court held that the commercial wisdom of Committee of Creditors (CoC) is not to be interfered with, excepting the limited scope as provided under Sections 30 and 31 of the Insolvency and Bankruptcy Code, 2016. It stated that “*the Court ought to cede ground to the commercial wisdom of the creditors rather than assess the resolution plan on the basis of quantitative analysis*”

8) P. Mohanraj vs M/S. Shah Brothers Ispat Pvt. Ltd (CIVIL APPEAL NO.10355 OF 2018)

The Supreme Court in March 2021 decided that when an order of moratorium is passed under the Insolvency and Bankruptcy Code, parallel proceedings under Section 138 of the Negotiable Instruments Act against the Corporate Debtor cannot be allowed to continue as the same will be covered by the bar under Section 14 of the IBC

9) Lalit Kumar Jain v. Union of India (TRANSFERRED CASE (CIVIL) NO. 245/2020)

The provisions of the Insolvency and Bankruptcy Code, 2016 concerning the liability of the personal guarantors to the corporate debtors were upheld. With the decision in place, the creditors can now initiate insolvency proceedings against individuals such as promoters, managing directors and chairpersons who stand as personal guarantors on the monies lent or goods and services extended to the corporate debtors.

10) Phoenix Arc Private Limited Vs Spade Financial Services Limited & Ors (Civil Appeal No. 2842 of 2020).

The Supreme Court has held that a financial creditor which is not a “related party” to the corporate debtor at present can also be excluded from the Committee of Creditors (CoC) if it is found that he was earlier a related party and had removed this label only to bypass S.21(2) Proviso.

9.11 SUMMARY

This unit explains the law and mechanism related to corporate insolvency resolution process for corporates in India. The unit commences describing the legal and regulatory situation in place prior to enacting of the Insolvency and Bankruptcy Code 2016. It further examines the need to adopt the Insolvency and Bankruptcy Code, 2016 (hereinafter referred to as IBC or the Code). It discusses the salient aspects of the Code with the help of leading cases.

9.12 SELF ASSESSMENT QUESTIONS

- 1) Define ‘Insolvency’.
- 2) Explain the corporate insolvency legislative framework in India prior to the Insolvency and Bankruptcy Code, 2016.
- 3) Discuss the corporate insolvency resolution process.
- 4) Explain the liquidation process under the Insolvency and Bankruptcy Code, 2016.
- 5) Discuss the four pillars of institutional infrastructure created by the Insolvency and Bankruptcy Code, 2016.

9.13 FURTHER READINGS/REFERENCES

Books:

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- 3) Jyoti Singh & Vishnu Shriram, *Insolvency and Bankruptcy Code, 2016- Concepts and Procedure*, Bloomsbury India Professional.
- 4) *EBC’s Insolvency and Bankruptcy Code, 2016: Manual of Bare Act along with Regulations*

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- ⁷ Sections 209 to 216 of IBC 2016
- ⁸ Section 214 of IBC 2016
- ⁹ Section 215 IBC
- ¹⁰ Section 60(1) IBC
- ¹¹ Section 60(2) IBC
- ¹² Section 63 IBC
- ¹³ Sections 179-183 of the IBC
- ¹⁴ Section 195, IBC 2016
- ¹⁵ Section 244, IBC 2016
- ¹⁶ S.3(12), IBC 2016
- ¹⁷ S.3(11), IBC 2016
- ¹⁸ S.3(6), IBC 2016
- ¹⁹ S.7, IBC 2016
- ²⁰ S.9, IBC 2016
- ²¹ S.10, IBC 2016
- ²² S.7(4), IBC 2016
- ²³ S.30 IBC
- ²⁴ S.13,14 IBC 2016
- ²⁵ S.29 IBC
- ²⁶ S.12 IBC
- ²⁷ S.55-58 of IBC
- ²⁸ S.33 IBC 2016
- ²⁹ S.31 IBC 2016
- ³⁰ S.85(4) IBC, 2016
- ³¹ S.80, 81 IBC, 2016
- ³² S.234, 235 of IBC 2016

BLOCK-5
**INTELLECTUAL PROPERTY AND DATA
MANAGEMENT**

Unit 10 Intellectual Property Rights

Unit 11 Data Protection and Privacy



UNIT 10 INTELLECTUAL PROPERTY RIGHTS

Objectives

After studying this unit, you should be able to:

- Understand the meaning of Intellectual Property
- Explain the need for protecting Intellectual Property
- Describe the different types of Intellectual Property

Structure

- 10.1 Introduction
- 10.2 Intellectual Property
- 10.3 Justification for protecting Intellectual Property
- 10.4 Types of Intellectual Property
 - 10.4.1 Patents
 - 10.4.2 Copyright
 - 10.4.3 Trademarks
 - 10.4.4 Geographical Indications
 - 10.4.5 Industrial Designs
 - 10.4.6 Plant Variety Protection
 - 10.4.7 Protection of Layout Designs of Integrated Circuits
 - 10.4.8 Trade Secrets
- 10.5 Summary
- 10.6 Self Assessment Questions
- 10.7 Further Readings/References

10.1 INTRODUCTION

We live in a world surrounded by diverse types of intellectual property rights. The books you read, the songs you hear, the movies you watch and the diverse apps you use on your phone are just some of the many kinds of works which might be or which might have been protected under different kinds of intellectual property protection. Thanks to the frequent appearances of the term “intellectual property” in mainstream media as well as every day conversations, it has by now become familiar among a substantial segment of the public. However, as in the case of the parable of blind men and an elephant, different people perceive IP very differently, depending on their source of information and their day to day interactions with different types of IP. For some, it is that branch of law which protects trade names or trade symbols while for some, it is a branch of law that protects technological innovations. For others, it may be a branch of law that protects movies and books. But many of them might find it difficult to define what IP is. Part of the reason for the diverging perceptions on IP and the difficulty in defining the term is the constant expansion of the subject matter covered under this area of law. Thanks to the expansion of subject matter over the years, it has become increasingly difficult to find common elements in all types of IP that can provide a comprehensive definition for the term.

Hence, one of the first things to remember is that IP is not a single, homogenous body of law, but rather a term that attempts to collectively describe a number of areas of law with distinctive characteristics.¹ The next section in this unit will provide learners an overview of some of the prominent definitions of IP to showcase its vast and dynamic character. Further, the discussions in the following sections seek to encourage the learners to critically analyse whether it would ever be possible to have one common definition for IP.

10.2 INTELLECTUAL PROPERTY

There is no universally accepted definition of ‘intellectual property’. This is not surprising, as it is nearly impossible to find one definition that can comprehensively cover all the subject matters that are currently considered as intellectual property.

The World Intellectual Property Organisation (WIPO) has provided a relatively more comprehensive definition which reads as follows:

*Intellectual property (IP) refers to creations of the mind, such as inventions; literary and artistic works; designs; and symbols, names and images used in commerce.*²

Some of the scholars like William Fisher highlight the fact that intellectual property is not a single homogenous law when he says that the term ‘*intellectual property*’ refers to a loose cluster of legal doctrines that regulate the uses of different sorts of ideas and insignia.³ However, if the term intellectual property refers to a loose cluster of legal doctrines, then it becomes pertinent to ask when we can call something as intellectual property. According to Bently and Sherman, the term ‘intellectual’ (adjective) indicates the character of some of the material this area of law protects, i.e., products of human mind/ intellect and the term ‘property’ indicates the form of regulation, i.e., the grant of exclusive rights which operate in a manner similar to property rights over tangibles.⁴

Different countries protect these diverse creations of the mind under different branches of law such as patent law, copyright law, trademark law, and design law. Together they are often referred to as ‘intellectual property laws’, though it needs to be kept in mind that it is becoming increasingly difficult to find common theoretical justifications for all such branches of law and that there are major differences between the legal and economic foundations of these laws.

10.3 JUSTIFICATION FOR PROTECTING INTELLECTUAL PROPERTY

While there are different theoretical rationales for affording legal protection to different types of IP, the most widely used one is the ‘incentive theory’, also known as ‘welfare theory’.⁵ According to the proponents of this theory, most information products like books or music have two characteristics of public goods.

The first characteristic is the non-rivalrous character in consumption. We say that a good has non-rivalrous character in consumption when more than one person is able to use the good simultaneously without affecting the possibilities of consumption of that good by another. For example, a digital copy of a book

which is stored on the cloud could be read by more than one person and each person would be able to read the book without diminishing the possibilities of enjoyment of reading of that book by another. On the other hand, if the book is in physical form or hard copy, only one person might be able to use that copy at a time. Most information products have non-rivalrous character in consumption.

The second characteristic is relative non-excludability. It is relatively hard to exclude people from the consumption of information goods. This is a particularly important challenge, as many information goods also have strong positive externalities. Economists argue that because of these public goods characteristics, inventors or creators will not have the incentives to create information products and there will ultimately be under-production of information goods.⁶ To address this issue of under-production, the economists suggest that there should be at least some legal protection against copying.

The legal protection suitable for different information products would have to be fine-tuned both in terms of duration of protection and scope of protection, keeping in mind both the requirements of protecting the incentives for production of such goods as well as the broader interest of the society in getting access to such products. Most laws that come under the broader umbrella of IP laws, particularly patents and copyrights, can be seen attempting to seek this fundamental balance through diverse measures such as limited term protection and exceptions to infringement.

In the context of trademarks, there are two commonly cited economic arguments.⁷ Firstly, trademarks can reduce consumer search costs. In the absence of trademarks, consumers may have to spend substantial amount of time and efforts to identify a product that they wish to consume. Secondly, in the absence of trademark protection, there may not be much incentives for producers to maintain or improve the quality of their products or services. In other words, trademarks have a self-enforcing characteristic when it comes to quality improvements.

10.4 TYPES OF INTELLECTUAL PROPERTY

As indicated earlier, IP law is not a homogenous body of law, but rather a collection of distinct, but related legal doctrines covering diverse subject matters. This subsection will explore the basic aspects of some of the major types of IP.

10.4.1 Patents

A patent is a limited term monopoly granted for an invention in return for the disclosure of the invention to the public.⁸ In India, patents are governed by the Patents Act 1970 and registration is mandatory for patent protection. Patents are granted after a rigorous examination process, which involves different steps. A patent application will contain the title of the invention, description of the invention in a manner in which a person skilled in the art could work or reproduce that invention, and a set of claims that defines the legal boundaries of the invention.

The term of patent protection in India is 20 years from the date of filing of the application.⁹ During the term of protection, patents ensure that the concerned invention cannot be made, sold, distributed, or used without the consent of the patent owner.¹⁰ Once the term of protection is over, the patents enter the public domain and anyone can use the invention in any manner they like.

A patentable invention can be relating to a product or a process. To be considered as an 'invention' for the purpose of patent law, there are three general requirements¹¹:

- 1) ***Novelty***;
- 2) ***Inventive step***; and
- 3) ***Industrial application***.

It is also important to ensure that the concerned product or process is not a specifically excluded subject matter under the relevant patent statute. In India, Sec. 3 of the Patents Act 1970 has provided a long list of exclusions from patent protection. These exclusions are based on diverse public policy reasons. Similarly, Sec. 4 of the Patents Act provides that inventions relating to atomic energy, which fall within sub-section (1) of Sec. 20 of the Atomic Energy Act 1962, are not patentable.¹²

While the term '**novelty**' has not been defined under the Patents Act 1970, the standards of novelty followed in India are clarified through Sec. 2(1)(l) of the statute, which has defined 'new invention'. As per this definition, new invention means "*any invention or technology which has not been anticipated by publication in any document or used in the country or elsewhere in the world before the date of filing of patent application with complete specification, i.e., the subject matter has not fallen in public domain or that it does not form part of the state of the art.*" In other words, publication of the details of the invention in any document or use of the invention in any part of the globe can negate novelty, and the patent application may be rejected on grounds of lack of novelty. However, it must be noted that novelty has to be determined in the light of a single prior art reference and 'mosaicking' is not permitted in novelty analysis.¹³ In other words, compiling different documents and then comparing it with the technological features disclosed in the application is not allowed. The cited prior art should disclose the invention either explicitly or implicitly. There also needs to be a complete match between all the technological features as disclosed in the application and the cited single prior art reference.¹⁴ However, the statute has also provided certain specific exceptions to anticipation.¹⁵

The second requirement, i.e., ***inventive step***, is the toughest requirement to meet among the three essential factors in patentability. In India, the Patents Act 1970 defines 'inventive step' as "*a feature of an invention that involves technical advance as compared to the existing knowledge or having economic significance or both and that makes the invention not obvious to a person skilled in the art.*"¹⁶ Inventive step analysis is done from the hypothetical construct of a Person Skilled In The Art (PSITA). The statute hasn't provided any definition for the terms technical advancement or economic significance. The statute also does not provide any specific guidelines for determining non-obviousness from the point of view of a person skilled in the art. However, the courts have evolved certain guidelines in this regard and an important decision in this regard is *Biswanath Prasad Radhey Shyam vs Hindustan Metal Industries*, a decision of the Supreme Court of India. In this decision the Court clarified that whether an alleged invention involves an 'inventive step' will be a mixed question of law and fact.¹⁷ The answer would invariably depend on the facts and circumstances of each application.

The third requirement for patentability, i.e., capable of ***industrial application***, is relatively easier to meet in most circumstances. As per Sec. 2 (1)(ac) of

Patents Act 1970, “capable of industrial application”, in relation to an invention, means that the invention is capable of being made or used in an industry.

It needs to be reminded that even if an applicant can show that the application meets all the three requirements of patentability, to be successful in a patent application, it is also important to ensure that the subject matter of the invention is not a specifically excluded subject matter under Indian patent law. As discussed earlier, India has a relatively long list of excluded subject matter under Sec. 3 of the Patents Act 1970. The list includes business models, computer programmes per se, and traditional knowledge. Accordingly, if the application belongs to any of those specifically excluded subject matter, it is bound to be rejected.

10.4.2 Copyright

Copyright protects creative and artistic works. The diverse kind of works that can be protected by copyright include books, music, movies, paintings, sculptures, and computer software. In India, copyright is governed by the Copyright Act 1957.

Copyright provides a bundle of rights for the creators and the types of rights provided would vary with the subject matter. For example, the bundle of rights provided under Indian copyright law for creators of literary works are:

- i) right to reproduce the work in any material form including the storing of it in any medium by electronic means;
- ii) right to issue copies of the work to the public not being copies already in circulation;
- iii) right to perform the work in public, or communicate it to the public;
- iv) right to make any cinematograph film or sound recording in respect of the work;
- v) right to make any translation of the work;
- vi) right to make any adaptation of the work; and
- vii) right to do any of the above, in relation to a translation or an adaptation of the work.¹⁸

On the other hand, for cinematograph films, the bundle of rights provided under Indian copyright law are only:

- i) right to make a copy of the film, including—
 - A) a photograph of any image forming part thereof; or
 - B) storing of it in any medium by electronic or other means;
- ii) right to sell or give on commercial rental or offer for sale or for such rental, any copy of the film; and
- iii) right to communicate the film to the public.¹⁹

As the example illustrates, depending on the subject matter, the type of rights and the extent of rights granted under copyright law to the creators would vary substantially.

Apart from these economic rights, some of the jurisdictions like India also strongly

protect certain non-economic rights of creators and they are known as moral rights. Under Copyright Act 1957, moral rights are referred to as author's special rights.²⁰ The moral rights protected under Copyright Act 1957 are:

- 1) right of attribution (right to be attributed as the author of her work); and
- 2) right of integrity (right to prevent or claim damages with regard to any changes made in the work that could harm the reputation of the creator).²¹

Unlike patents, registration is not mandatory for receiving copyright protection. Copyright protection is received the moment a copyrightable work is created. However, for most categories of works (literary, dramatic, musical and artistic works), to be copyrightable, the work needs to meet the requirement of 'originality'.²² To meet the requirement of originality, a work must be an independent creation and it should show some minimal amount of creativity. However, different jurisdictions follow different standards for the amount of creativity required to meet the requirements of originality.

In India, for a very long time, the courts followed the so called "sweat of the brow" approach, which focused primarily on the labour put in by the creators.²³ But in the landmark decision of the Indian Supreme Court in *Eastern Book Company v. D.B. Modak*, the Court rejected the sweat of the brow doctrine explicitly and adopted the skill and judgment test, which was laid down in the Canadian Supreme Court decision in *CCH Canadian v. Law Society of Upper Canada*.²⁴ As pointed out by the Supreme Court, as long as the work originated from the author (and not copied from another source) and the work is a product of exercise of skill and judgment, it can meet the requirements of originality under Indian copyright law.²⁵ In the EBC decision, the court also clarified that "*creative works by definition are original and are protected by copyright, but creativity is not required in order to render a work original.*"²⁶ In other words, the threshold level for meeting originality is not that high under Indian copyright law and works would qualify for protection as long as they can meet the minimum standards suggested in the EBC case.

As compared to patents, the duration of protection is much longer in the case of copyright. The term of copyright protection varies with the subject matter and duration for different subject matter under Indian copyright law are dealt with in Chapter V of the Copyright Act 1957.²⁷ The copyright protection for literary, dramatic, musical or artistic works (other than a photograph) published within the lifetime of the author continue until sixty years from the beginning of the calendar year next following the year in which the author dies.²⁸ The term of protection for photographs under Indian copyright law subsists until sixty years from the beginning of the calendar year next following the year in which the photograph is published.²⁹ For cinematograph films, the term of protection is until sixty years from the beginning of the calendar year next following the year in which the film is published.³⁰ The term of protection provided for sound recordings is sixty years from the beginning of the calendar year next following the year in which the sound recording is published.³¹ It is also important to note that moral rights protection in India extend beyond the term of copyright protection.³²

Collective management of rights is very common in the case of copyright, as it is difficult to monitor and enforce rights at the individual level. For this purpose, different copyright societies are established and they collectively manage the

rights of authors.³³ Some of the famous copyright societies include Indian Performing Right Society (IPRS), which deals with the rights of authors, composers and publishers of music.³⁴

While most discussions on copyright focus on the rights of creators of copyrighted works, it is also important to note that copyright law is not just about the rights of creators. Copyright law also provides many rights to the users of copyrighted works and they appear in the form of exceptions and limitations to copyright. In India, Sec. 52 of the Copyright Act 1957 provides a long list of exceptions to copyright infringement. While Sec. 52(1)(a) of Copyright Act 1957, which is known as the fair dealing exception, provides a relatively broad and open-ended exception, Sec. 52(1)(b) to Sec. 52(1)(zc) provides a long list of enumerated exceptions that cater to diverse access requirements in the country. For example, Sec. 52(1)(i) provides an important educational use exception. In a country like India, wherein the vast majority of students cannot afford to buy expensive reference books, such exceptions play an important role in ensuring access to knowledge.

10.4.3 Trademarks

Trademarks are another important type of IP rights. In general, a trademark refers to a word, symbol, or any other signifier that can distinguish the goods or services produced by one firm from the goods or services of another firm.³⁵ In India, trademarks are governed by Trademarks Act 1999.

The Trademarks Act 1999 defines a trademark as a mark capable of being represented graphically and which is capable of distinguishing the goods or services of one person from those of others and may include shape of goods, their packaging and combination of colours.³⁶ If one looks at the definition given for 'mark' under the Trademarks Act 1999, it can be seen that the term has been provided with an inclusive definition, so as to meet the contemporary as well as future requirements. As per Sec. 2(1)(m) of the statute, the term 'mark' *includes* a device, brand, heading, label, ticket, name, signature, word, letter, numeral, shape of goods, packaging or combination of colours or any combination thereof. Thanks to this inclusive approach, Indian trademark law is able to protect not just conventional signs like logos or words, but also many non-conventional marks like sound marks and colour marks, as long as they can meet the other requirements under the law, particularly the requirement that the sign should be capable of distinguishing the goods or services of the producer from those of others. With regard to the shapes, it needs to be noted that if the shape is resulting from the nature of the goods themselves, it cannot be protected as a trademark under Indian trademark law.³⁷ For example, the shape of a cricket ball cannot be registered as a trademark for the product category of cricket ball. Similarly, if the shape is necessary to obtain a technical result, it cannot be protected as a trademark.³⁸ This is also an important prohibition, as many producers might seek protection for technical solutions under trademark law, even if the same should have been a subject matter of protection under patent law. This is primarily due to the fact that the term of protection for trademarks is infinite, provided the producer renews the registration promptly. But allowing trademark owners to seek protection for technical solutions under trademark law would defeat the purpose of creating other types of IP regimes like patents, which provide a limited term monopoly right for inventors and ensure that those inventions can be used

by the general public after the expiry of the patent term. In the past, there have been attempts to protect inventions like a three-headed rotary shaver and the courts have denied trademark protection to such technical solutions.³⁹ Finally, if a shape adds substantial value to the goods, it cannot be protected as a trademark under Indian trademark law.⁴⁰

Indian trademark law also has a graphical representation requirement.⁴¹ In other words, a mark can be protected as a trademark in India, only if it can be represented graphically. Since non-conventional marks like taste marks and smell marks are hard to be represented graphically, they are generally considered not capable of attaining protection under the current Indian trademark law. The capacity of a mark to distinguish the goods or services of one undertaking from the goods or services of another is also an important requirement.

To obtain trademark protection in India, an applicant has to file a trademark application in the prescribed format before one of the trademark offices in India.⁴² The applications can be refused on several grounds which can be broadly classified as absolute grounds for refusal and relative grounds for refusal.⁴³ Once a trademark is granted in India, the protection is given for a duration of ten years and it can be renewed further.⁴⁴ Like most other types of IP rights, trademark protection is also territorial in character, and if a trader wishes to get trademark protection abroad, she may make use of the flexibilities provided under the Paris Convention.⁴⁵ The alternate option is to file an application under the Madrid Protocol (Protocol Relating to the Madrid Agreement Concerning the International Registration of Marks) route.⁴⁶ The Madrid Protocol is administered by the World Intellectual Property Organisation and India is a party to this international treaty. It provides an easier pathway for registering and managing trademarks in different member countries of the Madrid Protocol.⁴⁷ India became a party to the protocol in 2013 and currently many firms from India are using the Madrid Protocol to file trademark applications abroad.

Registration of a trademark in India provides the trademark owner the exclusive right to use the trade mark in relation to the goods or services in respect of which the trade mark is registered. It also entails her to obtain reliefs in respect of infringement of trade mark.⁴⁸ Trademark owners can assign or license their rights.

However, like most other areas of IP, such rights are also subject to the specific limitations and exceptions provided under the legislation.⁴⁹ For example, if a defendant is using a trademark only to describe the product of the competitor or to compare it to her own products, it will be a nominative use and it will not amount to infringement of trademark. Similar is the case of the use of trademarks for making a critical comment on someone's product or service.

One concept closely related to trademark infringement is passing off, which is a common law cause of action that can apply to diverse factual scenarios. It is the oldest of the modern legal regimes used for protecting trade symbols.⁵⁰ In a nutshell, this remedy can help a trader X to prevent a competitor Y from passing their goods or services off as if they were the goods or services of trader X.⁵¹ In *Reckitt & Colman v. Borden*, Lord Oliver has summarised the essence and essential elements of a passing off action as follows:

“The law of passing off can be summarised in one short general proposition – no man may pass off his goods as those of another. More specifically, it may be expressed in terms of the elements which the plaintiff in such an action has to prove in order to succeed. These are three in number. First, he must establish a goodwill or reputation attached to the goods or services which he supplies in the mind of the purchasing public by association with the identifying “get-up” (whether it consists simply of a brand name or a trade description, or the individual features of labelling or packaging) under which his particular goods or services are offered to the public, such that the get-up is recognised by the public as distinctive specifically of the plaintiff’s goods or services. Secondly, he must demonstrate a misrepresentation by the defendant to the public (whether or not intentional) leading or likely to lead the public to believe that goods or services offered by him are the goods or services of the plaintiff. Whether the public is aware of the plaintiff’s identity as the manufacturer or supplier of the goods or services is immaterial, as long as they are identified with a particular source which is in fact the plaintiff. For example, if the public is accustomed to rely upon a particular brand name in purchasing goods of a particular description, it matters not at all that there is little or no public awareness of the identity of the proprietor of the brand name. Thirdly, he must demonstrate that he suffers or, in a quia timet action that he is likely to suffer, damage by reason of the erroneous belief engendered by the defendant’s misrepresentation that the source of the defendant’s goods or services is the same as the source of those offered by the plaintiff.”⁵²

10.4.4 Geographical Indications

Geographical Indications (GI) broadly refers to signs used on products that have a specific geographical origin and the quality or the reputation of that product is attributable to that geographical origin.⁵³ The TRIPS Agreement has mandated protection of geographical indications.⁵⁴ In furtherance to the TRIPS Agreement, India has drafted a *sui generis* law for protecting GIs. The title of the legislation is the Geographical Indications of Goods (Registration and Protection) Act, 1999 (“GI Act”). However, even before the enactment of this legislation, passing off action has been acting as a powerful remedy in India against unauthorised use of GIs. It is still a very useful remedy in cases of authorized uses of unregistered GIs in India. Some of the producers have also been using certification marks and collective marks to protect GIs. For example, the word ‘Darjeeling’ and its logo were registered as certificate marks in India by the Tea Board of India.⁵⁵

GI Act defines the term ‘geographical indication’ as follows:

“Geographical indication, in relation to goods, means an indication which identifies such goods as agricultural goods, natural goods or manufactured goods as originating, or manufactured in the territory of a country, or a region or locality in that territory, where a given quality, reputation or other characteristic of such goods is essentially attributable to its geographical origin and in case where such goods are manufactured goods one of the activities of either the production or of processing or preparation of the goods concerned takes place in such territory, region or locality, as the case may be.”⁵⁶

As one may notice from the definition, the key requirement for GI protection is that the given quality, reputation or other characteristic of the good is *essentially attributable* to its geographical origin. While many of the GIs might be agricultural products or food-related products, it is important to remember that there could also be other categories of products such as handicrafts wherein the specific qualities of the products are attributable to human skills such as manufacturing skills or traditional knowledge in the location where the product was produced.⁵⁷ Examples of handicrafts protected as GIs in India include Aranmula Kannadi (mirror) and Kashmir Pashmina.⁵⁸

The term 'indication' is given an inclusive definition in the GI Act and as per the statute, "*indication includes any name, geographical or figurative representation or any combination of them conveying or suggesting the geographical origin of goods to which it applies.*"⁵⁹ Though many GIs consist of the name of the geographical location, it is important to remember that a GI registration could also be on figurative representations like logos or any combination of names and geographical or figurative representations. For example, the first and second GI applications filed in India under the GI Act were relating to the word 'Darjeeling Tea' and the logo of Darjeeling Tea, for tea produced from 87 tea gardens in the Darjeeling region.⁶⁰

To get GI protection, an application has to be filed in the prescribed format before the Geographical Indications Registry. As GI is a collective right, it is important to note that unlike trademark applications, individuals cannot file and get GI protection. The GI application has to be filed by an association of persons or producers or any organisation or authority representing the interest of producers of the concerned goods.⁶¹ The applicants are also required to file an affidavit clearly indicating how they represent their interest. Once a GI is granted, the registration is valid for a duration of 10 years and it can be renewed from time to time in accordance with the provisions of the statute.⁶² The registration of a GI can help the producers of such goods to prevent unauthorised uses of the GI by others. For example, with the GI registration, Kancheepuram Silk producers will be able to prevent anyone who is not an authorised producer of Kancheepuram silk from using the indication 'Kancheepuram' in their silk products. The possibilities for prevention of free riding on the reputation of GIs may help in quality control and increase in revenues. While registration provides legal protection against unauthorised uses of GIs, it is important to note that other remedies like passing off action can also be effective against unauthorised use of GIs, even when those indications are not registered under the GI Act.

10.4.5 Industrial Designs

Industrial designs is another type of IP rights, which has garnered considerable prominence in the context of high profile litigations such as *Apple v. Samsung*.⁶³ In the *Apple v. Samsung* litigation saga, one of the questions that had to be addressed by the courts was whether Apple was entitled to prevent competitors from using a rectangular shape with rounded corners and a round home button at the bottom of the screen on their phones.⁶⁴ In the United States, the jury initially awarded Apple \$1.049 billion in damages in 2012, on different grounds including the infringement of rights over those designs.⁶⁵ Even though IP scholars disagree on the justifiability of the outcomes in *Apple v. Samsung*, most scholars would agree that the litigation has raised awareness among firms on the economic importance of IP protection over aesthetic elements in a product.

Industrial designs is the type of intellectual property rights that protects the aesthetic or ornamental features of an article.⁶⁶ Unlike patents, which tries to protect the functional aspects, the focus here is only on the aesthetic aspects. In India, designs are protected under the Designs Act 2000. As per the statute, a design “[m]eans only the features of shape, configuration, pattern, ornament or composition of lines or colours applied to any article whether in two dimensional or three dimensional or in both forms, by any industrial process or means, whether manual, mechanical or chemical, separate or combined, which in the finished article appeal to and are judged solely by the eye; but does not include any mode or principle of construction or anything which is in substance a mere mechanical device, and does not include any trade mark as defined in clause (v) of sub-section(1) of section 2 of the Trade and Merchandise Marks Act, 1958 or property mark as defined in section 479 of the Indian Penal Code or any artistic work as defined in clause (c) of section 2 of the Copyright Act, 1957.” As one may notice from the definition, the scope of protection under design law is limited to aesthetic or ornamental aspects. However, its applications are unlimited and today design law has major implications in diverse fields such as pharmaceuticals, electronics, automobiles and fashion industry.

To receive design protection in India, one has to file an application as per the provisions of the Designs Act 2000. The substantive examination of the application includes answering four questions: Firstly, whether the application is a ‘design’, as defined under the Act; Secondly, whether the design is new or original; Thirdly, whether the design is prejudicial to public order or morality; and Fourthly, whether the design is prejudicial to the security of India.⁶⁷ To be registered, the design should not have been published or used anywhere in the world before the date of application.⁶⁸ However, the originality requirement won’t be defeated when a known shape or pattern is applied in a novel manner.⁶⁹

The registration confers ‘copyright’ in the design for the duration of registration and the registered owner will have the exclusive right to apply that design to the article in the class for which it is registered.⁷⁰ The duration of copyright protection in the design shall be initially for a period of 10 years from the date of registration.⁷¹ But the protection may be extended for another 5 years, provided the applicant files an application in the prescribed format, before the expiry of the initial 10 years.⁷²

10.4.6 Plant Variety Protection

Given the enormous demands from diverse stakeholders for protecting new plant varieties, different countries have taken different steps for protecting new plant varieties. In some countries, they are protected under patent law and in some others, they are protected under *sui generis* laws. The TRIPS agreement, to which India is a signatory, has mandated that member states “shall provide for the protection of plant varieties either by patents or by an effective *sui generis* system or by any combination thereof.”⁷³ In other words, though the TRIPS agreement has mandated protection of plant varieties, it has also provided sufficient flexibility to the member states to decide the path for protection. Being a country wherein a substantial portion of the population is engaged in agriculture, India decided to follow the path for a *sui generis* system that can balance the interests of both the innovators and the users of such innovations. This attempt for finding a balance

in the rights is visible even in the title of the legislation India enacted in this regard - the Protection of Plant Varieties and Farmers' Rights Act, 2001 ("PPVFR Act").

The PPVFR Act defines a 'variety' as "*a plant grouping except micro-organism within a single botanical taxon of the lowest known rank, which can be - (i) defined by the expression of the characteristics resulting from a given genotype of that plant grouping; (ii) distinguished from any other plant grouping by expression of at least one of the said characteristics; and (iii) considered as a unit with regard to its suitability for being propagated, which remains unchanged after such propagation, and includes propagating material of such variety, extant variety, transgenic variety, farmers' variety and essentially derived variety.*"⁷⁴

The statute defines a 'farmer' as "*any person who - (i) cultivates crops by cultivating the land himself; or (ii) cultivates crops by directly supervising the cultivation of land through any other person; or (iii) conserves and preserves, severally or jointly, with any person any wild species or traditional varieties or adds value to such wild species or traditional varieties through selection and identification of their useful properties.*"⁷⁵

The different categories in which a plant variety can be registered in India are New Variety, Extant Variety, and Essentially Derived Variety (EDV).⁷⁶ A new variety can be registered under the Act if the variety meets the requirements of novelty, distinctiveness, uniformity and stability. As per the statute, a variety shall be deemed **novel**, if on the date of filing of the application for registration, "*the propagating or harvested material of such variety has not been sold or otherwise disposed of by or with the consent of its breeder or his successor for the purposes of exploitation of such variety—(i) in India, earlier than one year; or (ii) outside India, in the case of trees or vines earlier than six years, or in any other case, earlier than four years, before the date of filing such application.*"⁷⁷ The proviso to the provision has also clarified that the trials conducted for a new variety, which has not been sold or otherwise disposed of, shall not affect the novelty requirement.⁷⁸ The distinctiveness requirement would be met, when the variety is "*clearly distinguishable by at least one essential characteristic from any another variety whose existence is a matter of common knowledge in any country at the time of filing of the application.*"⁷⁹ The uniformity requirement would be met, "*if subject to the variation that may be expected from the particular features of its propagation it is sufficiently uniform in its essential characteristics.*"⁸⁰ Finally, the variety would be considered as stable, "*if its essential characteristics remain unchanged after repeated propagation or, in the case a particular cycle of propagation, at the end of each such cycle.*"⁸¹

As per the statute, an **extant variety** means "*a variety available in India which is - (i) notified under section 5 of the Seeds Act, 1966(54 of 1966); or (ii) farmers' variety*⁸²; or (iii) a variety about which there is common knowledge; or (iv) any other variety which is in public domain."⁸³

According to PPVFR Act, an **essentially derived variety**, in respect of a variety (the initial variety), shall be said to be essentially derived from such initial variety when it – "*(i) is predominantly derived from such initial variety, or from a variety that itself is predominantly derived from such initial variety, while retaining the expression of the essential characteristics that results from the genotype or combination of genotype of such initial variety; (ii) is clearly distinguishable*

from such initial variety; and (iii) conforms (except for the differences which result from the act of derivation) to such initial variety in the expression of the essential characteristics that result from the genotype or combination of genotype of such initial variety."⁸⁴

In the case of trees and vines, the initial registration confers 9 years protection from the date of registration and it is renewable, subject to the condition that the total duration of protection cannot exceed 18 years from the date of grant of registration.⁸⁵ For other crops, the initial duration of protection is 6 years and the total duration cannot exceed 15 years from the date of grant of registration.⁸⁶ For extant varieties notified under Section 5 of Seeds Act 1966 also, the total duration of protection cannot exceed 15 years from the date of notification under the Seeds Act 1966.⁸⁷ During the period of registration, subject to the specific limitations provided in the statute, exclusive rights are vested with the breeder or her successor, her agent or licensee and to produce, sell, market, distribute, import or export the variety.⁸⁸

However, as discussed earlier, what makes the Indian statute unique is its attempt to balance the interests of all stakeholders. As a result, one can see strong rights vested upon farmers as well. This includes the right for farmers to save, use, sow, resow, exchange, share or sell her farm produce, including seeds of varieties protected under the Act, in the same manner as she was entitled to before the coming into force of this Act.⁸⁹ The only condition is that the farmer cannot put the seeds in any package or any other container and label it in a manner which may convey that such seed is of a variety protected under the Act.⁹⁰ Similarly, researchers are also vested with certain important rights under the PPVFR Act.⁹¹ This includes the freedom to use any of the registered varieties for conducting experiments or research.⁹²

10.4.7 Protection of Layout Designs of Integrated Circuits

In India, the layout designs of integrated circuits are specifically protected under the Semiconductor Integrated Circuits Layout-Designs Act, 2000. This statute was enacted in furtherance to the obligations of India under the TRIPS Agreement.⁹³

The statute defines a semiconductor integrated circuit as "*a product having transistors and other circuitry elements which are inseparably formed on a semiconductor material or an insulating material or inside the semiconductor material and designed to perform an electronic circuitry function.*"⁹⁴ 'Layout Design' is defined in the statute as "*a layout of transistors and other circuitry elements and includes lead wires connecting such elements and expressed in any manner in a semiconductor integrated circuit.*"⁹⁵

To be protectable, a layout design has to be original; not been commercially exploited in India or in a convention country; inherently distinctive; and distinguishable from other registered layout-designs.⁹⁶ However, the proviso to Sec. 7 clarifies that any layout design which has been commercially exploited in India or in a convention country for not more than 2 years shall be treated as not been commercially exploited in India or in a convention country. The requirements of 'originality' under the statute will be met if the layout design is the result of the creator's own intellectual efforts and is not commonly known to creators of layout designs and manufacturers of integrated circuits at the time of creation.⁹⁷

The duration of protection for layout designs in India is 10 years from the date of filing the application or commercial exploitation in any country, whichever is earlier.⁹⁸ Semiconductor Integrated Circuits Layout-Design Registry (“SICLDR”) is the office accepting applications under the Semiconductor Integrated Circuits Layout-Designs Act, 2000.

10.4.8 Trade Secrets

Trade secrets are IP rights over confidential information. Some of the most prominent examples of information protected as trade secrets include the Coke recipe and the recipe behind Kentucky Fried Chicken. Other information like customer lists can also qualify for trade secrets protection. However, not all information would qualify to attain trade secrets protection. To qualify for trade secrets protection, there are primarily three requirements: Firstly, the confidential nature of the information makes the information a commercially valuable one; secondly, the information is known among only a limited group of persons; and lastly, the holder of the information has taken reasonable steps to keep the information secret.⁹⁹

Art. 39 of the TRIPS Agreement has mandated the protection of trade secrets by the member states. The provision reads as follows:

“Natural and legal persons shall have the possibility of preventing information lawfully within their control from being disclosed to, acquired by, or used by others without their consent in a manner contrary to honest commercial practices so long as such information:

- a) is secret in the sense that it is not, as a body or in the precise configuration and assembly of its components, generally known among or readily accessible to persons within the circles that normally deal with the kind of information in question;*
- b) has commercial value because it is secret; and*
- c) has been subject to reasonable steps under the circumstances, by the person lawfully in control of the information, to keep it secret.”*

However, the TRIPS Agreement has provided sufficient flexibility to the member states in determining the paths through which trade secret protection may be given. While some countries have enacted specific laws for the protection of trade secrets, countries like India protect trade secrets through principles of equity and common law remedies for breach of confidence.¹⁰⁰ Like most other types of IP rights, trade secrets can also be assigned or licensed.

10.5 SUMMARY

As one may notice from the discussions in this unit, different kinds of IP rights play a major role in determining access to knowledge and resources today. The significance of different kinds of IP rights may only increase as we shift more and more to a knowledge based economy. One of the important issues that needs to be kept in mind while engaging in any policy reforms in this area is the need for retaining a fair balance between the rights of IP holders and that of the society. The current IP related debates in the context of the Covid19 pandemic should be a good reminder on the need for retaining a fair balance within the IP system.

10.6 SELF ASSESSMENT QUESTIONS

- 1) Are the following statements true or false
 - a) Registration is not mandatory for getting copyright protection in India.
 - b) By filing a patent application in India, an inventor can protect his invention from patent infringements across the globe.
 - c) India provides patent protection for new plant varieties.
 - d) India has a sui generis legal system for protecting geographical indications.
 - e) The duration of trademark protection is for a maximum of 50 years from the date of grant of a trademark.
- 2) What are the major types of intellectual property rights?
- 3) What are the differences between trademarks and geographical indications?
- 4) What are the differences between industrial designs and patents?
- 5) How are trade secrets protected in India?
- 6) What are the requirements for patentability in India?

10.7 FURTHER READINGS/REFERENCES

Books:

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- ³ William Fisher, 'Theories of Intellectual Property' in Stephen Munzer (ed), *New Essays in the Legal and Political Theory of Property* (Cambridge University Press, 2001) <<http://www.law.harvard.edu/faculty/tfisher/iptheory.html>> accessed 13 September 2020.
- ⁴ Lionel Bently and Brad Sherman, *Intellectual Property Law* (Oxford University Press, 2014) 1.
- ⁵ For an excellent overview of different theories of intellectual property, see William Fisher, 'Theories of Intellectual Property'.
- ⁶ Ibid.
- ⁷ Ibid. For detailed discussion on other economic arguments, see William M. Landes and Richard Posner, 'Trademark Law: An Economic Perspective' <<https://cyber.harvard.edu/IPCoop/87land1.html>> accessed 13 September 2020.
- ⁸ Lionel Bently and Brad Sherman, *Intellectual Property Law* (Oxford University Press, 2003) 309.

- ⁹ See Sec. 53 of Patents Act 1970.
- ¹⁰ World Intellectual Property Organisation, *What is Intellectual Property?*, 5 <https://www.wipo.int/edocs/pubdocs/en/intproperty/450/wipo_pub_450.pdf> accessed 14 September 2020.
- ¹¹ See Sec. 2(1)(j) of Patents Act 1970, which defines the term ‘invention’.
- ¹² See Sec. 4 of Patents Act 1970.
- ¹³ Kalyan C. Kankanala, Arun K, Narasani and Vinita Radhakrishnan, *Indian Patent Law and Practice* (Oxford University Press, 2012) 25.
- ¹⁴ Ibid.
- ¹⁵ See Sec. 29(1), Sec. 29(2), Sec. 29(3), Sec. 30, Sec. 31, Sec. 32, and Sec. 33 of Patents Act 1970.
- ¹⁶ See Sec. 2(1)(ja) of Patents Act 1970.
- ¹⁷ *Biswanath Prasad Radhey Shyam vs Hindustan Metal Industries* <<https://indiankanoon.org/doc/1905157/>> accessed 4 November 2020.
- ¹⁸ See Sec. 14 (a) of Copyright Act 1957.
- ¹⁹ See Sec. 14(d) of Copyright Act 1957.
- ²⁰ See Sec. 57 of Copyright Act 1957
- ²¹ Ibid.
- ²² Lionel Bently and Brad Sherman, *Intellectual Property Law* (Oxford University Press, 2003) 80. See also, Sec. 13(1)(a) of Copyright Act 1957. As one may notice from Sec. 13(1)(b) and Sec. 13(1)(c) of Copyright Act 1957, for sound recordings and cinematograph films, the statute doesn’t require the work to be original to qualify for protection.
- ²³ For example, see *Burlington Home Shopping Pvt Ltd. v. Rajnish Chibber* (Delhi High Court, 1995) <<https://indiankanoon.org/doc/130087/>> accessed 14 September 2020.
- ²⁴ See *Eastern Book Company v. D.B. Modak* (2008) 1 SCC 1 and *CCH Canadian v. Law Society of Upper Canada* (2004) 1 SCR 339.
- ²⁵ See *Eastern Book Company v. D.B. Modak*, Para 37.
- ²⁶ Ibid.
- ²⁷ See Sec. 22 to 29 of Copyright Act 1957.
- ²⁸ See Sec. 22 of Copyright Act 1957.
- ²⁹ See Sec. 25 of Copyright Act 1957.
- ³⁰ See Sec. 26 of Copyright Act 1957.
- ³¹ See Sec. 27 of Copyright Act 1957.
- ³² See Sec. 57 of Copyright Act 1957.
- ³³ Chapter VII of the Copyright Act 1957 deals with copyright societies in India.
- ³⁴ <<https://www.iprs.org/about-iprs/>> accessed 14 September 2020.
- ³⁵ See William M. Landes and Richard Posner, ‘Trademark Law: An Economic Perspective’ <<https://cyber.harvard.edu/IPCoop/87land1.html>> accessed 13 September 2020.
- ³⁶ See Sec. 2(1)(zb) of Trademarks Act 1999.
- ³⁷ See Sec. 9(3)(a) of Trademarks Act 1999.

- ³⁸ See Sec. 9(3)(b) of Trademarks Act 1999.
- ³⁹ For example, see *Koninklijke Philips Electronics Ltd. v. Remington Consumers Products Ltd.*, (CJEU, C-299/99, 2002).
- ⁴⁰ See Sec. 9(3)(c) of Trademarks Act 1999.
- ⁴¹ See the definition given for 'trademark' in Sec 2(zb) of Trademarks Act 1999.
- ⁴² For the list of trademark offices and their jurisdiction, see <www.ipindia.nic.in/%2Flocations-and-jurisdiction.htm> accessed 14 September 2020.
- ⁴³ Sec. 9 of the Trademarks Act 1999 deals with absolute grounds for refusal of registration and Sec. 11 of the Trademarks Act deals with relative grounds for refusal of registration.
- ⁴⁴ See Sec. 25 of Trademarks Act 1999.
- ⁴⁵ <<https://www.wipo.int/treaties/en/ip/paris/>> accessed 14 September 2020.
- ⁴⁶ <<https://www.wipo.int/madrid/en/>> accessed 14 September 2020.
- ⁴⁷ For details regarding the working of Madrid system, <https://www.wipo.int/export/sites/www/madrid/en/forms/docs/making_the_most_of_the_madrid_system_mm_forms.pdf> accessed 14 September 2020.
- ⁴⁸ See Secs. 28 and 29 of Trademarks Act 1999.
- ⁴⁹ See Sec. 30 of Trademarks Act 1999.
- ⁵⁰ Lionel Bently and Brad Sherman, *Intellectual Property Law* (Oxford University Press, 2003) 671.
- ⁵¹ Ibid.
- ⁵² *Reckitt & Colman Products Limited v. Borden Inc. & Others*, [1990] R.P.C. 341, 406.
- ⁵³ World Intellectual Property Organisation, *Geographical Indications - An Introduction* (2017) 8 <https://www.wipo.int/edocs/pubdocs/en/geographical/952/wipo_pub_952.pdf> accessed 14 September 2020.
- ⁵⁴ See Sec. 3 (Art. 22 to Art 25) of TRIPS Agreement.
- ⁵⁵ <<http://www.teaboard.gov.in/TEABOARDCSM/NQ>> accessed 14 September 2020.
- ⁵⁶ See Sec. 2(1)(e) of Geographical Indications of Goods (Registration and Protection) Act, 1999.
- ⁵⁷ World Intellectual Property Organisation, *Geographical Indications - An Introduction*, 10 <https://www.wipo.int/edocs/pubdocs/en/geographical/952/wipo_pub_952.pdf> accessed 14 September 2020.
- ⁵⁸ http://www.ipindia.nic.in/writereaddata/Portal/Images/pdf/GI_Application_Register_10-09-2019.pdf
- ⁵⁹ See Sec. 2(1)(g) of Geographical Indications of Goods (Registration and Protection) Act, 1999.
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- ⁶¹ See Sec. 11(1) of Geographical Indications of Goods (Registration and Protection) Act, 1999.

- ⁶² See Sec. 18(1) of Geographical Indications of Goods (Registration and Protection) Act, 1999.
- ⁶³ <<https://www.lexology.com/library/detail.aspx?g=bd796b2e-c0a0-409a-b0f0-ed8570418401>> accessed 14 September 2020.
- ⁶⁴ Ibid. and also see U.S. Design Patent No. D593087.
- ⁶⁵ Josh Lowensohn, ‘Jury Awards Apple More than \$1B, Finds Samsung Infringed’ (CNET, 24 Aug 2012) <<https://www.cnet.com/news/jury-awards-apple-more-than-1b-finds-samsung-infringed/>> accessed 14 September 2020. However, in a second jury trial subsequent to the appeals, damages awarded to Apple were reduced substantially. <<https://www.nytimes.com/2018/05/24/business/apple-samsung-patent-trial.html>> accessed, 14 September 2020.
- ⁶⁶ In some jurisdictions like the United States, they are referred to as design patents.
- ⁶⁷ See Secs. 2(d), 2(g), 5(1) and 46 of the Designs Act 2000.
- ⁶⁸ See Sec. 4(b) of Designs Act 2000.
- ⁶⁹ See Sec. 2(g) of the Designs Act 2000.
- ⁷⁰ See Sec. 2(1)(c) of the Designs Act 2000.
- ⁷¹ See Sec. 11(1) of the Designs Act 2000.
- ⁷² See Sec. 11(2) of the Designs Act 2000.
- ⁷³ See Art. 27(3)(b) of the TRIPS Agreement.
- ⁷⁴ Sec. 2(za) of the Protection of Plant Varieties and Farmers’ Rights Act 2001.
- ⁷⁵ Sec. 2(k) of the Protection of Plant Varieties and Farmers’ Rights Act 2001.
- ⁷⁶ See Sec. 15 and Sec. 23 of the Protection of Plant Varieties and Farmers’ Rights Act 2001.
- ⁷⁷ See Sec. 15(3)(a) of the Protection of Plant Varieties and Farmers’ Rights Act 2001.
- ⁷⁸ Ibid.
- ⁷⁹ See Sec. 15 (3)(b) of the Protection of Plant Varieties and Farmers’ Rights Act 2001.
- ⁸⁰ See Sec. 15(3)(c) of the Protection of Plant Varieties and Farmers’ Rights Act 2001.
- ⁸¹ See Sec. 15(3)(d) of the Protection of Plant Varieties and Farmers’ Rights Act 2001.
- ⁸² Sec. 2(l) defines ‘farmers variety’ as follows: *Farmers’ variety” means a variety which—(i) has been traditionally cultivated and evolved by the farmers in their fields; or (ii) is a wild relative or land race of a variety about which the farmers possess the common knowledge.*
- ⁸³ See Sec. 2(i) of the Protection of Plant Varieties and Farmers’ Rights Act 2001.
- ⁸⁴ See Sec. 2(j) of the Protection of Plant Varieties and Farmers’ Rights Act 2001.
- ⁸⁵ See Sec. 24(6) of the Protection of Plant Varieties and Farmers’ Rights Act 2001.
- ⁸⁶ Ibid.

⁸⁷ Ibid.

⁸⁸ Sec. 28 of the Protection of Plant Varieties and Farmers' Rights Act 2001.

⁸⁹ See Sec. 39 of the Protection of Plant Varieties and Farmers' Rights Act 2001.

⁹⁰ See the explanation to Sec. 39 (1)(iv) of the Protection of Plant Varieties and Farmers' Rights Act 2001, which defines "branded seed" as any seed put in a package or any other container and labelled in a manner indicating that such seed is of a variety protected under this Act.

⁹¹ Sec. 30 of the Protection of Plant Varieties and Farmers' Rights Act 2001.

⁹² Ibid.

⁹³ See Arts. 35 to 38 (Section 6) of the TRIPS Agreement.

⁹⁴ See Sec. 2(1)(r) of the Semiconductor Integrated Circuits Layout-Designs Act, 2000

⁹⁵ Sec. 2(1)(h) of the Semiconductor Integrated Circuits Layout-Designs Act, 2000.

⁹⁶ See Sec. 7 of the Semiconductor Integrated Circuits Layout-Designs Act 2000, which talks about layout designs that cannot be registered.

⁹⁷ See Sec. 8 of the Semiconductor Integrated Circuits Layout-Designs Act 2000.

⁹⁸ Sec. 15 of the Semiconductor Integrated Circuits Layout-Designs Act 2000.

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¹⁰⁰ Chandni Raina, 'Trade Secret Protection in India: The Policy Debate' (Centre for WTO Studies Working Paper Series) 9 <<http://wtocentre.iift.ac.in/workingpaper/Trade%20Secret%20Protection%20in%20India-%20The%20policy%20debate.pdf>> accessed, 8 September 2020 and Kamakhya Srivastava, 'Trade Secrets In Indian Courts' <<https://www.mondaq.com/india/trade-secrets/204598/trade-secrets-in-indian-courts>> accessed 8 September 2020).

UNIT 11 DATA PROTECTION AND PRIVACY

Objectives

After studying this unit, you should be able to:

- Describe evolution of the right to privacy and other key elements and principles of data protection in India.
- Highlight the Information Technology Act, 2000, and the provisions therein that relate to data protection;
- Discuss the need for specific data protection legislations;
- Explain the state of the data protection framework in India
- Appreciate the provisions of the Personal Data Protection Bill, 2019

Structure

- 11.1 Introduction
- 11.2 Privacy as an Evolving Concept in the Digital Context
- 11.3 Right to Privacy In India
- 11.4 Information Technology Act and the Right to Privacy
- 11.5 Right to Privacy and the Need for Specific Data Protection Laws
- 11.6 Data Protection Framework in India
- 11.7 The Personal Data Protection Bill, 2019
- 11.8 Summary
- 11.9 Self-Assessment Questions
- 11.10 References

11.1 INTRODUCTION

We live in a world where each and every second of our life creates millions of bits of data about us. For example, every keystroke we make on our phones conveys extensive data about us. This includes, but is not limited to, several personal aspects of our life like what time we wake up, how much time we spent on our phone, what apps we use, with whom all we communicate, with whom we communicate most, what we prefer to eat, what we prefer to shop, what our current health condition is, where we are traveling, where we want to travel, and even, which movie we may want to watch next. Similarly, every financial transaction we do digitally within or outside our phones, creates extensive data about our financial behaviours. If you are a fitness tracker user, even your movements within and outside your home may be creating diverse data about your physical activities. While the individual bits of data about us may not always be problematic, the aggregation of data can result in detailed profiling of the individuals, with enormous consequences. The use of data for targeted/ personalised advertisements is just one of the many such consequences for the privacy rights of individuals. Unfortunately, most of the data gathering happens without any explicit permission from us, and far too often without any notification of the gathering of data. Therefore, a robust data protection framework is very much necessary for protecting the privacy rights of individuals. This unit will

provide an overview of the current legislative and policy framework regarding privacy rights and data protection in India.

11.2 PRIVACY AS AN EVOLVING CONCEPT IN THE DIGITAL CONTEXT

One of the primary factors that necessitated the evolution of privacy rights was the need to safeguard and preserve the dignity of an individual and consequently preventing unauthorized disclosure of personal information in the public domain. As defined by Samuel D. Warren and Louis D. Brandeis, two among the earliest scholars, who contributed immensely to the evolution of privacy laws, “*privacy is a concept encompassing the inviolate personality of a person, which does not include within its ambit matters which are privileged, published with consent or, existing in the public domain.*”¹ Over the years, privacy rights have risen to become one of the most prominent factors for facilitating self-definition irrespective of whether an individual is in public or in a private space.²

But with the advent of the digital age, the scale of data produced and used have changed drastically. The ability to store large swathes of data and their subsequent analysis using diverse data mining techniques have unearthed unprecedented opportunities for firms to use and trade on personal data. The fast developments in the area of artificial intelligence further contributes to unparalleled challenges to privacy and autonomy.³ The manner in which the digital revolution impacts privacy, particularly the concerns with regard to the misuse and manipulation of personal information, has also given rise to the concept of informational privacy.⁴

While anecdotal accounts might suggest that awareness about privacy rights might be improving among the public due to the diverse discussions on privacy in the mainstream media as well as social media, most people still rarely hesitate to surrender their informational privacy in return for the receipt of free or ‘better’ services, or ‘convenience’ in the digital context. The manner in which most of us share our location data with so many apps on our phones or smart watches is just one of the many examples in this regard. At times, firms might also not give consumers any choices. When a firm takes an approach that they will allow consumers to use their services only if they agree to the data policies of the firm, consumers are often left with no choices, but to agree to the terms of the firm. It is in this broader context that we need strong legislative and policy frameworks that can protect the privacy rights of consumers.

This Unit attempts to trace the evolution of the right to privacy and other key elements and principles of data protection in India. Accordingly it has six parts—namely, **First**, that deals with a brief summary on the evolution of privacy as a right in India, in particular through judicial pronouncements; **Second**, the Information Technology Act, 2000 and the provisions therein that relate to data protection; **Third**, the need for specific data protection legislations; **Fourth**, the state of the data protection framework in India – the aspect which receives elaboration in the next two sections namely the **Fifth**, that discusses the salient features of the Justice Srikrishna Committee Report and the Personal Data Protection Bill, 2018; and **Sixth**, a discussion on the provisions of the Personal Data Protection Bill, 2019, with particular reference to the departures it has made from the 2018 Bill.

11.3 RIGHT TO PRIVACY IN INDIA

While the Constitution of India does not explicitly mention the right to privacy, the courts in India have dealt with the question of whether privacy is a fundamental right in India. The case of *M.P Sharma v. Satish Chandra*, decided by an eight-judge bench of the Supreme Court, dealt with questions regarding the legitimacy of the search warrant issued under Section 96(1) of the Criminal Procedure Code, 1973, and was the first ever case to touch upon aspects related to privacy.⁵ The Apex Court has in that case held that the fundamental right to privacy was not a guaranteed right under the Indian Constitution. This position was reiterated in *Kharak Singh v. State of Uttar Pradesh*.⁶ However, cases such as *PUCL v. Union of India*⁷, which held tapping of telephones to be an infringement of the right to privacy, and *Selvi v. State of Karnataka*⁸, which declared the use of investigation techniques including polygraph, narco-analysis and BEAP without the prior consent of an individual amounting to violation of an individual's privacy, necessitated the need to resolve the conundrum regarding the status of the right to privacy under the Constitution.

Finally, a larger Bench of the Supreme Court had the opportunity to address this question in *K.S Puttaswamy v. Union of India*.⁹ This case arose in the context of Aadhar, the biometric ID system of the Government of India. In this case, the constitutional validity of Aadhaar was challenged on the ground that it violated the right to privacy of an individual. It was contended that Aadhar posed a serious threat to an individual's privacy by compromising on their bodily integrity as it required collection and storage of biometric information for authentication (fingerprints, iris scans), opening up possibilities of misuse. Further, the collection of personal information also heightened the risks regarding data security, coupled with dangers associated in relation to data storage and data breaches.¹⁰

The judgment of the Supreme Court in that case discussed many key aspects and laid down the essential principles in relation to the guarantee, protection, promotion and fulfilment of the right to privacy.¹¹ Chandrachud J. held that the right to privacy is an aspect of human dignity and is a basic *natural* right. He also made observations regarding informational privacy and the impact of privacy in the digital economy and highlighted the requirement of a data protection law.¹² Chelameshwar J. held that privacy consists of three major elements - repose (freedom from groundless stimuli), sanctuary (safeguarding against invasive observation), and intimate decision (freedom to make personal and intimate life choices).¹³ Kaul J, emphasized on the claims against the state actors (issues of surveillance and profiling), and non-state actors (technological influence which encompasses collection, storage and dissemination of big data). Bobde J. recognized it as a fundamental right consisting of two facets - firstly, restricting legislative powers and secondly, affording conditions for the advancement of individuals.¹⁴

The judgement also discussed elements of judicial review and how they can be accommodated in cases of invasion into privacy by the State. Chelameshwar J. highlighted the significance of the idea and the concept of reasonableness in Part III of the Constitution and its varying role depending on the right in question, by stating that infringement of privacy due to arbitrary action by state would exact testing its reasonableness under Art. 14, violation of privacy with respect to Art. 19 must fall within the exceptions provided, and actions infringing Art. 21 must

be just, fair and reasonable, and including instances requiring “highest standard of scrutiny” which can only be warranted in cases of compelling state interest.¹⁵ Nariman J. cited instances to assert that restrictions on privacy must be tested on the combination of rights being encroached, while Bobde J. held that privacy invasions will have to satisfy not only the tests under the particular rights but also those applicable under Art. 21.¹⁶ In Sapre J.’s opinion, the state may place reasonable restrictions on the right to privacy only on the basis of social or moral or compelling public interest.¹⁷

Arguably, the combined reading of the opinions of Chandrachud J. (who wrote on behalf of four judges, including himself) and Kaul J. can provide a clearer picture of the legal test for infringement of privacy in India. The test suggests the need for looking at four elements: legality (the presence of law), legitimate goal (law made must be for a legitimate state aim); the existence of a rational connection between the aim sought to be achieved and the privacy infringing state action; and the test of proportionality (that there must exist a rational nexus between the objects that needs to be achieved and the means).¹⁸

The Court directed the Union Government to set up a data protection regime, for safeguarding individual interests in relation to infringement of privacy. Pursuant to the judgement, the government formed a committee of experts under the leadership of Justice B.N Srikrishna to consider all issues related to data protection and come up with a draft legislation thereon. The recommendations of the committee and the subsequent legislative developments are discussed later in this Unit.

11.4 INFORMATION TECHNOLOGY ACT AND THE RIGHT TO PRIVACY

Though not a legislation drafted primarily with the aim of privacy protection in the digital context, some of the provisions of the Information Technology (IT) Act, 2000 have implications for privacy protection. For example, Section 43A of the IT Act deals with compensation for failure to protect ‘data’ and clarifies that an enterprise handling any Sensitive Personal Data (SPD) or information can be held liable for causing any wrongful gain or wrongful loss by being negligent in establishing reasonable security practices and procedures in handling SPD or information.¹⁹ While this statute does not define ‘sensitive personal data’, the term ‘data’ has been given a broad definition in this statute. It is defined as “a representation of information, knowledge, facts, concepts or instructions which are being prepared or have been prepared in a formalised manner, and is intended to be processed, is being processed or has been processed in a computer system or computer network, and may be in any form (including computer printouts magnetic or optical storage media, punched cards, punched tapes) or stored internally in the memory of the computer”.²⁰

Rule 3 of the IT Rules, 2011 has however provided a definition for ‘sensitive personal data or information’ and as per the Rule, sensitive personal data or information of a person means such personal information which consists of information relating to (i) password; (ii) financial information such as Bank account or credit card or debit card or other payment instrument details; (iii) physical, physiological and mental health condition; (iv) sexual orientation; (v) medical records and history; (vi) Biometric information; (vii) any detail relating

to the above clauses as provided to body corporate for providing service; and (viii) any of the information received under above clauses by body corporate for processing, stored or processed under lawful contract or otherwise. However, Rule 3 also clarifies that any information which is available in the public domain or furnished under any law will not fall within the purview of the provision.²¹

Section 66E of the IT Act deals with voyeurism and provides that any person, who willfully captures, publishes or disseminates the image of a private part of any individual without consent, leading to violation of their privacy, shall be liable to punishment with imprisonment extending up to three years, or fined for an amount not more than two lakh rupees, or with both.²²

Section 72 of the IT Act provides penalty for breach of confidentiality and privacy by statutory authorities empowered under the IT Act to secure access to private information in the form of record, book etc. and, for its consequent disclosure to a third person without the consent of the person concerned.²³ As per the provision, violators may face imprisonment up to two years or fine upto one lakh rupees, or both imprisonment and fine.

Section 72A provides punishment for disclosure of information in breach of lawful contract by any person including an intermediary, who has gotten access to personal information about a person and without his consent discloses it to another with an intent to cause wrongful loss or wrongful gain.²⁴ The prescribed punishment is imprisonment upto three years or fine upto five lakh rupees or both.

The transfer of personal data is regulated by the Information Technology (Reasonable Security Practices and Procedures and Sensitive Personal Data or Information) Rules, 2011.

Rule 4 directs body corporate collecting, receiving, or storing information, to provide a privacy policy for dealing with the personal information and to guarantee that the same can be viewed by the providers of such information. This Rule further directs the body corporate or any person on its behalf to publish on the website the statements, type, the purpose of collection and, the reasonable security practices employed by the former.²⁵ Rule 5 provides that the collection of information by a body corporate shall be done only after obtaining consent in writing from the provider of the information.²⁶ Rule 6 provides that disclosure of SPD or information by the body corporate can only be done post obtaining the consent of the provider of the information where it is required for complying with any legal obligation.²⁷ Rule 7 lays down that the transfer of SPD or information to any other body corporate located in India or any other country, shall only be done with the consent of the provider after guaranteeing that the level of data protection offered there is commensurate with these rules.²⁸

As we can see, some of these provisions do deal with protection of privacy rights. However, it is now indisputable that the effectiveness and adequacy of these provisions have been in dealing with the privacy related challenges in the digital context are far from ideal. Some provisions of the IT Act such as Sections 69, 69A, and 66A (which was struck down²⁹) may have also resulted in chilling effects on free speech by empowering authorities to issue blocking orders to network providers based on interceptions.³⁰ Also, the provisions were increasingly proving inadequate to deal with the increasing amount of data breaches.³¹

11.5 RIGHT TO PRIVACY AND THE NEED FOR SPECIFIC DATA PROTECTION LAWS

Protection of privacy in the current digital context requires framing of specific policies and procedures that can minimise the intrusion of both private persons (including companies) and the state into the privacy of an individual by generating, collecting, storing, using, collating or deriving data about the individuals. For the purpose of discussions in this unit, data can be categorized into two - personal data and non-personal data.³² Personal data includes characteristics or traits, which may be used to identify an individual, while non-personal data, on the other hand, encompasses aggregated data which may not serve in identifying an individual.³³

If we look at the data protection approaches in the United States, China and Europe, one can see them taking diverging approaches to data protection, based on their respective socio-political requirements and outlooks. For example, the United States pursues a *somewhat laissez-faire* approach and is seen not so keen to have a specific comprehensive legislative framework for data protection, with the emphasis traditionally being on protection of business interests and deregulation. The US uses an amalgamation of constitutional provisions and general laws for establishing a framework for privacy protection.³⁴ China does not have a unified data protection legislation like that of the European Union (EU) and takes reference from numerous sector-specific legislations to establish a data protection regime.³⁵ Provisions relating to protection of personal data also appear in the PRC cyber security law of 2017, despite it being touted as a national security legislation.³⁶ In EU, the Data Protection Directive was adopted by the European Commission in 1995 which laid out the framework for data protection regulation. The directive provided a framework for processing of personal data, including rules in relation to collection and destruction of data.³⁷ In 2018, EU took the approach of drafting a comprehensive privacy legislation, with great emphasis on the protection of user rights, through extensive discussions among the member states to enact the General Data Protection Regulation (GDPR). Under this legislation, the state is entrusted with strengthening the individuals' privacy in the digital era and for laying down privacy rules as regards companies and public bodies.³⁸

11.6 DATA PROTECTION FRAMEWORK IN INDIA

It may be recalled from the discussions in the earlier part of this unit, in the Puttaswamy decision, the Supreme Court had categorically mentioned the need for an appropriate data protection framework in India.³⁹

In July 2017, the Indian government decided to form a committee to study various dimensions of data protection and suggest inputs for an appropriate legislative framework in the area. Under the chairmanship of Justice (Retd.) B. N. Srikrishna, the committee gave a comprehensive report delineating the rationale for a robust legal framework for data protection and the committee also provided a Draft Personal Data Protection Bill.⁴⁰

Key aspects of the Justice (Retd.) Srikrishna Committee Report:

The Srikrishna Committee Report defined personal information to include any data which may be used to identify an individual, either directly or indirectly.⁴¹ Personal data was defined on the basis of their identifiability, with the law including processing by private and public entities.⁴² Sensitive personal data was to include financial information, passwords, health information, sexual orientation, religious and political inclination, sexual orientation, with the Data Protection Authority (DPA) empowered to include further categories.⁴³ The Committee also sought to differentiate personal data protection from the protection of sensitive personal data.⁴⁴ The Committee noted that the relationship between the individual and any service provider must be observed to be a fiduciary relationship (a relationship based on fundamental expectation of trust between the two parties) and that there should be a fine balancing of interests between the two.⁴⁵ This conception of the relationship also led to the committee adopting the terminology of ‘data principal’ and ‘data fiduciary’ – as opposed to the terminology used in other data protection legislations in the world i.e. as that of ‘data subject’ and ‘data controller’.

The establishment of a regulatory framework stems from the fact that there is a need for protecting the rights of an individual, referred to as the *data principal*, who is the focal actor in a digital ecosystem with reference to their personal data.⁴⁶ The basis of a fiduciary relationship is the expectation by an individual regarding fair use of her or his data for legitimate purposes. Hence, there arises a duty on the part of the entities collecting the data for dealing with the data responsibly. Such entities are referred to as *data fiduciaries*.⁴⁷

The draft bill suggested regulation of personal data by providing rules for protection of autonomy of individuals with reference to their data, along with laying down norms for processing, collection and storage of such data by the data processing entities.⁴⁸ The report provided a number of recommendations starting with the need for setting up an independent regulatory authority, the Data Protection Authority (DPA), which would be entrusted with the enforcement of the law.⁴⁹ The DPA, as per the suggestions of the report, shall be empowered to classify certain data fiduciaries as significant data fiduciaries depending on their power to cause greater harm in pursuance of their data processing techniques.⁵⁰ The data fiduciaries have been mandated to undertake obligations, including consenting to data audits, data protection impact assessments, along with getting registered with the DPA.⁵¹ The DPA was also bestowed with enforcement mechanisms empowering them to issue directions, calling for information, publishing guidance and codes of practice, providing injunctive measures while carrying out inquiry, issuing warnings, cease and desist orders, and suspension of business of entities violating the law.⁵² Establishment of an appellate tribunal for adjudicating and disposing off appeals against any order of the DPA also found place in the suggestions in the committee report.⁵³

As per the suggestions in the report, consent was considered to be mandatory for processing of personal data. The report suggests adoption of a modified consent framework, where data fiduciaries shall be held liable for any *harm* befalling on the data principal.⁵⁴ Consent needs to be free, specific, clear, informed, and capable of being withdrawn in order to be valid.⁵⁵ The report also suggests that processing of personal data by the fiduciaries must be fair and reasonable.⁵⁶ Data fiduciaries shall be bound to follow the principles of *purpose limitation*⁵⁷ (data fiduciary

shall use the personal data collected only for the purpose for which the data principal expects it to be used), *transparency*⁵⁸, *providing notice*⁵⁹ (right at the time of collection of personal data), and *storage limitation*⁶⁰ (storage of data only for the time period required to fulfill the purpose for which it was collected). Also, processing cannot be performed in the absence of an express consent by the data principal, unless the purpose for the same has been communicated at the time of collection.⁶¹

The Committee also recommended the inclusion of data principal rights - such as *right to confirmation* (data principal's right to inquire about the processing of her/ his personal data), *access* (right of the data principal to obtain access to her/ his personal data in the control of the data fiduciary), *correction*,⁶² *right to data portability*⁶³ (right to receive and transfer the data stored with the data fiduciary), *right to object to processing*,⁶⁴ *right to object to direct marketing*⁶⁵, and the *right to be forgotten*⁶⁶ (right of the data principals to de-link, amend, or correct the information that may be disclosed on the Internet by the data fiduciary).

The draft bill also proposed a three-tier system based on the data localization requirements. Data has been categorized as - *personal data*, *sensitive personal data*, and *critical personal data*. While personal data may be allowed to be transferred freely, sensitive personal data may be transferred only after obtaining explicit consent by the data principal, and subject to government approval.⁶⁷ Critical personal data may not be transferred except on very limited grounds.⁶⁸ Cross border transfer of data, apart from critical personal data (not subject to cross border transfer, which may only be processed in India), may only be done with the help of a model contract containing clauses holding the transferor liable for any harm caused to the data principal due to violation of the law.⁶⁹

The Committee also provided grounds where processing may be done on non-consensual grounds, which include, welfare functions of the state, compliance with any law or order of a court or tribunal, or any other reasonable purpose.⁷⁰ Further, the processing of personal data or sensitive personal data may be exempted in certain situations, including, in the interest of security of state, for personal or domestic purposes, disclosure of personal data for the purpose of legal proceedings, for acts in contravention of any law in force, personal purposes and, manual processing by small entities.⁷¹ The draft bill laid down that the Data Protection Authority (DPA) may levy penalties on the data fiduciaries for failure to comply with data processing obligations, the directions issued by the DPA or, cross-border data storage and transfer requirements.⁷² The report along with the draft bill was submitted to the Ministry of Electronics and Information Technology on July 27, 2018.

11.7 THE PERSONAL DATA PROTECTION BILL, 2019

The Personal Data Protection Bill (PDP Bill) was introduced in the Lok Sabha on 11.12.2019, and it was subsequently forwarded to a Joint Parliamentary Committee (JPC)⁷³. While the Bill has retained many elements of the draft bill provided by the Srikrishna Committee, it has also made some radical changes. This section will highlight the major differences between the draft bill provided by the Srikrishna Committee and the Bill which was introduced in the Lok Sabha.

The definition of personal data, which was defined in a way so as to include characteristics, traits or attributes of identity used to identify an individual, was expanded to also include any inference being drawn from such data for profiling purposes.⁷⁴ The definition of sensitive personal data which included passwords as per the Bill proposed by the Srikrishna Committee, was amended to remove passwords from under this category.⁷⁵ The power to categorise personal data as sensitive personal data, which was conferred upon the Data Protection Authority (DPA) under the draft PDP Bill, has been granted to the Central Government (in consonance with DPA) under the 2019 Bill.⁷⁶

The Srikrishna Committee bill had no reference to social media intermediaries. However, the 2019 PDP bill not only provided a definition but further necessitated the social media intermediaries classified as significant data fiduciaries to provide a voluntary user verification mechanism for all users.⁷⁷ The Srikrishna Committee bill had further exempted the State from abiding by the requirements of the bill while processing personal data in the interest of national security, as long as it was permissible under law and performed in a fair and reasonable manner.⁷⁸ The 2019 bill, on the other hand, grants the government the power to exempt any of its agencies from the provisions of this Act in certain cases (security of state, sovereignty and integrity of India, public order etc.), thus enhancing the powers of the Government.⁷⁹

The 2019 PDP Bill incorporates data subject rights such as the right to erasure, granting the right to the data principal to request data fiduciaries for erasing any personal data that may have been stored by the latter once the purpose has been fulfilled.⁸⁰ The Srikrishna Committee bill also required one serving copy of all personal data to be stored in India every time transfer of personal data took place outside the country.⁸¹ This mandatory storage requirement for all personal data has been removed in the 2019 PDP bill, necessitating only mirror copies of sensitive personal data and critical personal data to be stored in the country.⁸² The conditions for transfer of sensitive personal data also includes receiving express consent by the individual whose data is being transferred outside the Country.⁸³

The composition of the Data Protection Authority (DPA) was also subjected to certain modifications in the 2019 PDP bill. Under the Srikrishna Committee bill, the selection committee was empowered to give recommendations to the Central Government for the appointment of members of the Data Protection Authority, comprised of (i) Chief Justice of India or a Judge of Supreme Court as the chairperson, (ii) Cabinet Secretary, and (iii) an expert in field of data protection, information technology and related subjects.⁸⁴ However, the 2019 Bill does away with the requirement of a judicial member from the selection committee. The selection committee, as per the 2019 Bill consists of (i) Cabinet Secretary as the chairperson, (ii) Secretary, Department of Legal Affairs, and (iii) Secretary, Ministry of Electronics and Information Technology.⁸⁵

While the Srikrishna Committee Bill neither defined non-personal data nor envisaged application of non-personal data by the Government for making policies for digital economy or security, the 2019 PDP bill, in addition to defining the term, also empowers the government to direct data fiduciaries to provide any non-personal data and anonymised personal data for better targeting of provision of services.⁸⁶ Additionally, the 2019 PDP Bill has brought forth the concept of privacy by design policy whereby every data fiduciary has to prepare a privacy by design policy and get it approved by the Data Protection Authority.⁸⁷

11.8 SUMMARY

As the Supreme Court has clarified through the landmark decision in *Puttaswamy* case, the right to privacy is a fundamental right in India. Like many other fundamental rights, while a privacy right cannot be considered as an absolute right, it is very important that effective and adequate measures are put in place to protect privacy rights, particularly in the current digital context wherein the threat of infringement by actors including the state is non-trivial and profound. A robust data protection regime that can assure the best possible protection of privacy rights for individuals is the need of the time. The key principles laid down by the Supreme Court in the *Puttaswamy* decision has been a good starting point for designing a robust data protection regime for India.

The report of the Joint Parliamentary Committee on Personal Data Protection Bill has been tabled before both the houses of the Parliament on December 16, 2021. With the bill titled as “The Data Protection Bill, 2021”, it looks to regulate not just personal data as was envisaged by the Srikrishna Committee, but also include within its scope non-personal data until a framework to differentiate between personal and non-personal data is set up by the Government.

11.9 SELF ASSESSMENT QUESTIONS

- 1) In which of the following case did Supreme Court held that privacy is a fundamental right in India?
 - a) Kharak Singh v. State of Uttar Pradesh b) M.P Sharma v. Satish Chandra
 - c) K.S Puttaswamy v. Union of India d) Gobind v. State of M.P
- 2) GDPR stands for -
 - a) Global Directive for Privacy Regulation b) General Data Protection Regulation
 - c) Global Data Protection Regulation d) General Directive for Privacy Regulation
- 3) Which provision of the Information Technology Act, 2000, deals with violation of privacy?
 - a) Section 72A b) Section 66B c) Section 72 d) Section 66E
- 4) Which of the following has not been recognized as a user right under the Personal Data Protection Bill, 2019?
 - a) Right to access b) Right to be forgotten
 - c) Right to anonymous speech d) Right to data portability
- 5) Based on data localization requirements, the PDP Bill has categorized personal data into _____ types
 - a) 4 b) 5 c) 3 d) 2
- 6) Briefly discuss the provisions under the Information Protection Act, 2000, having privacy implications.
- 7) Write a short note on the essential principles laid down by the Supreme Court in *K.S Puttaswamy v. Union of India*.
- 8) Enumerate and discuss the set of user rights provided by the Srikrishna Committee on personal data protection.

- 9) Briefly discuss the principles laid down in Srikrishna Committee Report finding place in the PDP Bill, 2019.
- 10) Write a brief note on the changes brought about by the Personal Data Protection Bill, 2019.

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- ⁷² Draft Personal Data Protection Bill, 2018, PRS LEGISLATIVE RESEARCH <https://prsindia.org/billtrack/draft-personal-data-protection-bill-2018> (Last accessed on Oct. 9, 2021).
- ⁷³ JPC gets time to present a report on the personal data protection bill. (Jul. 23, 2021) <https://www.livemint.com/news/india/jpc-to-see-time-to-present-report-on-personal-data-protection-bill-11627017273374.html> (Last accessed on Oct. 08, 2021).
- ⁷⁴ Personal Data Protection Bill, 2019, § 3(28), No. 373 (India).
- ⁷⁵ *Id.* at § 3(36).
- ⁷⁶ Anurag Vaishnav, The Personal Data Protection Bill, 2019: All you need to know, PRS LEGISLATIVE RESEARCH (Dec. 23, 2019), <https://prsindia.org/theprsblog/personal-data-protection-bill-2019-all-you-need-know>.
- ⁷⁷ PDP Bill 2019, *supra* note 74, at § 26.
- ⁷⁸ *Id.* at § 42.
- ⁷⁹ *Id.* at § 35.
- ⁸⁰ *Id.* at § 18(1)(d).
- ⁸¹ PDP Bill 2018, *supra* note 42, at § 40.
- ⁸² DEFENDER OF YOUR DIGITAL FREEDOM, Key Changes in the Personal Data Protection Bill, 2019 from the Srikrishna Committee Draft, <https://sflc.in/key-changes-personal-data-protection-bill-2019-srikrishna-committee-draft>. (Last accessed on Oct. 09, 2021).
- ⁸³ *Ibid.*
- ⁸⁴ PDP Bill 2019, *supra* note 74, at § 50(2).
- ⁸⁵ *Id.* at § 42(2).
- ⁸⁶ *Id.* at § 91.
- ⁸⁷ *Id.* at § 22.

BLOCK-6

BUSINESS AND SUSTAINABILITY

Unit 12 Environment Protection and Sustainability

Unit 13 Competition Law

Unit 14 Consumer Protection Law



UNIT 12 ENVIRONMENT PROTECTION AND SUSTAINABILITY

Objectives

After studying this unit, you should be able to:

- Understand the key constitutional provisions in India relating to Environment
- Discuss the International Developments in the field of Environmental Law and its impact on Businesses and Industries
- Appreciate the important provisions of Water Act, 1974, Air Act 1981, Environment Act, 1986, and Forest Act, 1980.
- Describe the major schemes that have been specially implemented for the MSME sector.

Structure

- 12.1 Introduction
- 12.2 Evolution of Environmental Protection Legislation in India
- 12.3 Environmental framework in India and its impact on businesses and industries
- 12.4 Implementation, Compliance, and Enforcement
- 12.5 Judicial Forums on environmental protection and liability of corporates
- 12.6 Climate Change and India
- 12.7 Schemes, Fiscal Policies, and market-based measures
- 12.8 Important Developments
- 12.9 Summary
- 12.10 Self Assessment Questions
- 12.11 References

12.1 INTRODUCTION

In the past fifty years the world has developed ample understanding on the relationship between human beings and environment. The Stockholm Declaration adopted at the United Nations Conference on Environment in Stockholm, 1972, placed environmental issues at the forefront of international concerns and marked the start of a dialogue between industrialized and developing countries on the link between economic growth, the pollution of the air, water, oceans and the well-being of people around the world.

In the general debate, special emphasis was placed on the role of corporations, as most developing nations protested against the activities of multinational corporations and argued that there was rampant exploitation of natural resources by the developed countries. The need for more effective and less wasteful utilization of natural resources was underlined by several speakers.¹

Since 1972 awareness on environmental issues has steadily increased. Human activities such as deforestation, burning of fossil fuels, changes in land use, rising

population, excessive use of natural resources, rampant industrialization have adversely affected the environment. However, such issues often take a back seat in view of industrialization, economic growth and maximising profits.

In an effort to link economic development and environmental stability, Brundtland commission published a report titled “Our Common future” in 1987 which talks about the concept of Sustainable development and defined it as,

“Development that meets the needs of the present without compromising the ability of future generations to meet their own needs”²

This last decade has seen several important developments in the international arena which specifically deal with sustainable industrialisation, production and consumption.

The 2030 Agenda for Sustainable Development adopted in September 2015 includes 17 Sustainable Development Goals, specifically SDG 9³ and SDG 12⁴ puts the onus of sustainable development not just on the governments but also on other stakeholders like industries, businesses and consumers. Under the International Framework for Climate Change, Kyoto Protocol ⁵ and Paris Agreement⁶ have both called for the financial assistance from developed countries with more financial resources to those countries that are more vulnerable and are less financially endowed. Further, the Paris Agreement had seen unprecedented participation of several companies including Mahindra group from India showcasing their clean technologies and pledging to reduce greenhouse gas emissions at the Caring for Climate business forum.

It is important to imbibe a culture of sustainability and profitability with clean and sustainable technologies within the corporate structure. In recent years, realising the economic impacts of environmental pollution⁷ and climate change, even the corporate sector has acknowledged that addressing environmental issues and tackling climate change is key to managing risks and ensuring long term returns on investment.

International Finance Corporation in its report⁸ suggests that climate financing cannot be done by governments alone, in fact private entities are far more suitable to invest in climate friendly projects, it further states that between 2018 -2030, USD 3.4 trillion dollars of Climate investment opportunities in key sectors will arise in South Asia, if NDC's are met by countries in the South Asia, out of this USD 3.1 trillion dollar of opportunities will be presented in India alone.

However, the global economy continues to grow, resulting in a possible tripling of resource extraction by 2050.⁹ There is widespread increase in population especially in developing countries wherein the current world population of 7.3 billion is expected to reach 9.7 billion by 2050. There is increase in global consumption, manufacturing, pollution levels and we are nowhere near to achieving the target set at the Paris agreement (1.5 degree celsius increase) which will further aggravate the negative impacts on our environment, livelihood and health.

Dealing with such multidisciplinary and cross sectoral issues, requires two-pronged strategy, *firstly*; develop proactive legal mechanisms with effective compliance and monitoring for reducing pollution as well as creating a comprehensive framework of liability and payable damages and *secondly*;

promoting sustainable industrial development and infrastructure by way of appropriate incentive-based schemes, fiscal policies and market mechanisms. It is important to note that successful implementation of such measures depends on the collective effort of all the relevant stakeholders including governments, consumers along with industries and businesses.

12.2 EVOLUTION OF ENVIRONMENTAL PROTECTION LEGISLATION IN INDIA

India's approach towards environmental protection was piecemeal and reactive in nature. In response to Stockholm declaration 1972, Air (Prevention and Control of Pollution) Act, 1981, and Water (Prevention and Control of Pollution) Act, 1974, were introduced. Further, Art 48 A and 51(g) were incorporated in Indian Constitution by way of 42nd amendment in 1976.

It is unfortunate to note that beyond causing continual environmental harms industries can also be responsible for severe and large-scale disasters resulting in the deaths of millions of people. India was ill fated to witness one of the world's worst industrial disasters in the form of Bhopal gas tragedy in 1984 killing thousands of people.

This incident was a turning point for environmental jurisprudence in India. Several prominent legislations, rules, notifications were adopted after this incident taking into account issues and challenges that increasingly emerged as part of modern-day developments. India experienced a virtual explosion of public interest litigations specifically on environmental issues and courts also assumed a more pro-active role in the form of public educator¹⁰, policy maker¹¹ and administrator¹². India even started contemplating on having a specialized tribunal dealing specifically with environmental matters¹³ as the Supreme Court stressed on its importance in numerous instances.¹⁴ Finally after much deliberation and failed attempts, National Green Tribunal was established in 2010. Since its inception, it has played an important role in shaping the environmental litigation in India.¹⁵

Thus, India started adopting a more holistic and comprehensive approach towards environmental protection and regulating the pollution emanating from industries.

Constitutional provisions for Environmental Protection:

The Indian Constitution is a living document which has evolved and grown with time. Substantive provisions for environmental rights and duties were lacking in our original Constitution. However, its landscape was changed by way of 42nd amendment which introduced specific provisions for environmental protection in the form of Directive Principles of State Policy¹⁶ and Fundamental Duties¹⁷. With the introduction of these two Articles, both the State and the Citizens are now under the constitutional obligation to protect, preserve and safeguard the environment.

Article 21 of the Indian Constitution states that, "no person shall be deprived of his life or personal liberty except according to procedure established by law". Supreme Court in the case of *Virender Gaur Ors. vs. State of Haryana*¹⁸ interpreted the word 'life' in a liberal manner and stated that,

‘Article 21 protects right to life as a fundamental right. Enjoyment of life and its attainment including their right to life with human dignity encompasses within its ambit, the protection and preservation of environment, ecological balance free from pollution of air and water, sanitation without which life cannot be enjoyed. Any contra acts or actions that would cause environmental, ecological, air, water, pollution, etc. should be regarded as amounting to violation of Article 21.’

Further, in the case of *M.C Mehta v. Union of India*¹⁹ the Supreme Court treated the right to live in healthy and pollution-free environment as a part of fundamental right to “life” under Article 21 of the Constitution.

Public Interest Litigations under art. 32 and art 226 also resulted in a wave of environmental litigations, producing a rich environmental jurisprudence in India. Thus, India’s Constitution now guarantees a right to healthy environment²⁰, right to clean air²¹, right to clean water²² etc.

Article 19 (1) (g) of the Indian constitution confers fundamental right on every citizen to practice any profession or to carry on any occupation, trade or business. However, it is subject to reasonable restrictions. In the case of *Burra bazar Fireworks Dealers Association v. Commissioner of police, Calcutta*²³ it was held that,

“Art. 19(1)(g) of the Constitution of India does not guarantee the fundamental right to carry on trade or business which creates pollution or which takes away that community’s safety, health and peace.”

12.3 ENVIRONMENTAL FRAMEWORK IN INDIA AND ITS IMPACT ON BUSINESSES AND INDUSTRIES

In the present section we will be dealing with Environment Protection Act 1986, Water (Prevention and Control of Pollution) Act 1974, Air (Prevention and Control of Pollution) Act 1981, Forest Conservation Act 1980 and The Wildlife (Protection) Act, 1972, etc.

a) *Water (Prevention and Control of Pollution) Act 1974*

In order to deal with the issue of water pollution, the Water Act was enacted in 1974 with the primary objective of prevention and control of water pollution and maintaining or restoring the wholesomeness of water. The Act specifically prohibits the disposal of any poisonous, noxious or polluting matter directly or indirectly into any stream, well, sewer or land.²⁴ In order to achieve its objective, it established Central and State Pollution Control Boards with the function of developing standards for effluents and sewage as well as the quality of water etc. It empowers the State Boards to obtain information from any establishment regarding its construction, installation or operation with a view to prevent and control water pollution.²⁵ It also authorizes the State Boards to take water samples from any stream, well, sewage or trade effluent passing through any plant or vessel.²⁶ The act further authorises the State Boards²⁷ to enter and inspect any plant, record, register, or document in order to determine whether the orders or directions of Boards

have been complied with or not. With regard to the power of entry and inspection, the State Boards shall have the powers of district magistrate under section 94 of CRPC relating to search and seizure. It is important to point that if an offence is committed under this Act by a company, then every person who at the time of offence, was responsible for the affairs of the company or in charge thereof shall be guilty of the offence and punished accordingly.²⁸ The Act provides for a wide array of penalties ranging from imprisonment of 3 months to 6 years and daily fines as well in case of continuous violations.

Consent to Establish and Consent to Operate-Establishment of any industry, operation or process, which is likely to discharge sewage or trade effluent into a stream, well, sewer, well or land requires prior consent of the Board.²⁹

b) *Air (Prevention and Control of Pollution) Act 1981*

The Act was enacted in 1981 to provide for the prevention, control and abatement of air pollution in India. In the case of *New Era High School v. State of Bihar*³⁰ it was stated that,

“Statute mandates board to inspect air pollution control areas at intervals, assess quality of air therein and take steps for prevention, control and abatement of air pollution in such areas”

The Act includes noise pollution. It specifically prohibits the industries from emitting air pollutants in excess of the standards laid down by the State Boards.³¹ Similar to the Water Act, the Air Act also authorises the State Boards with the power to obtain information³², power of entry and inspection³³, power to take samples from air emissions³⁴ and permits action against company officials in case of contravention of its provisions by a company³⁵. The Air Act as well provides for a wide array of penalties ranging from imprisonment of 3 months to 6 years and daily fines in case of continuous violations.

Consent to Establish and Consent to Operate- The Act requires certain industrial plants to apply for consent from the State Boards before establishing or operating any industrial plant in an air pollution control area.³⁶ The Board while granting consent may also impose certain conditions, which are required to be followed by the concerned industry. Failure to comply with conditions or operating without appropriate consent could result in the closure of the industry. Supreme Court in the case of *M.C Mehta v. Union of India*³⁷ held that,

“Carrying of mining operation of stones on the border of Rajasthan and U.P without obtaining necessary permission from competent authority was held to be illegal and persons were restrained from working out mining activities”

c) *Environment (Protection) Act 1986*

Even though there were existing laws in India dealing directly or indirectly with a vast array of environmental issues, India still lacked a general legislation for environmental protection in India. Due to constantly changing paradigms in the field of environmental law, a need was felt to have an

umbrella legislation for environmental protection in India, which would enable better coordination between regulatory authorities and provide for speedy and adequate responses to varying environmental issues. Further, Bhopal Gas tragedy also exacerbated the loopholes in the existing system of environmental protection and highlighted the need for an all-encompassing legislation for the protection of environment in India. In view of these issues the Environment (Protection) Act was enacted in 1986. The Act gave sweeping powers to the Central Government³⁸, providing that it could take, “*all such measures as it deems necessary or expedient for the purpose of protecting and improving the quality of the environment and preventing, controlling and abating environmental pollution.*” In particular, for instance, measures could include restriction of areas in which any industries, operations or processes shall not be carried out or shall be carried out subject to certain safeguards; laying down procedures and safeguards for prevention of accidents which may cause environmental pollution and remedial measures for such accidents; laying down procedures and safeguards for handling of hazardous substances; examination of such manufacturing processes, materials and substances as are likely to cause environment.³⁹

The Act also empowered the Central Government to make rules by notification on specific issues pertaining to environmental conservation and protection.⁴⁰ However, each rule made under the Act, is required to be laid before each House of the Parliament.⁴¹ In light of this power, Central Government has been able to issue notifications on a plethora of environmental issues in India such as waste management, environmental impact assessment, Coastal Regulation Zone (CRZ) etc.

The Act also provides for a penalty of imprisonment ranging from five years to seven years along with fines which may extend to Rs. one lakh and daily fines of Rs.5000 in case of continuous contravention.

- i) **Coastal Regulation Zones Notification:** The first CRZ Notification was issued in 1991, since then there have been several changes and amendments in these notifications. The most recent notification was implemented in 2019. As per the 2019 notification, CRZ's have been classified as follows:
 - CRZ I A- Ecologically Sensitive Areas, which play an important role in maintaining the integrity of coast such as mangroves, coral reefs, salt marshes, nesting grounds for birds and animals etc.
 - CRZ I B- Inter- tidal zone i.e., area between High tide line and low tide line
 - CRZ II- developed areas upto or close to shoreline.
 - CRZ III- Land areas that are relatively undisturbed, have further been classified as A and B based on population density.
 - CRZ IV- deals with water areas and sea bed areas and further classified into A and B on the basis of distance from Low tide line.

The new notification has certain provisions which are favourable for industries and businesses such as:

- Clearance procedures for projects or activities located in CRZ-I and CRZ-IV to be dealt with by the Ministry of Environment, Forests & Climate Change. Whereas, powers for clearance under CRZ-II and CRZ-III have been delegated to State level with necessary guidance.
- There is a boost for the tourism industry as temporary tourism facilities like shacks, toilets, change rooms, drinking water facilities have been permitted in the No Development Zone of CRZ-III areas with a minimum distance of 10m from the HTL.
- The notification also lifted the prohibition on construction in the previously-protected 200-metre no-development zone in rural areas and 100-metre no-development zone along the tidal-influenced water bodies, reducing it to 50 meters for these water bodies and densely populated rural areas. This will make way for more real estate, Hotels and resorts.

As per the 1991 Development Control Regulation, Floor Area Ratio had been frozen. As of now it stands defreezed and Floor Space Index is permitted for construction projects which imply a boost for the real estate sector.

- ii) **Waste Management Rules:** In a developing country like India with high consumption pattern and huge quantities of different kinds of waste, lack of proper management and disposal system can be a serious issue. Several rules have been notified in India dealing with different kinds of waste such as municipal solid waste, plastic waste, hazardous waste, bio- medical waste, etc. These rules are based on the principle of making stakeholders accountable for the management of waste. Most importantly, the rules stipulate that it is the responsibility of the producers to ensure that the waste generated from their products is disposed of in an environmentally friendly manner. It can be defined as, "*a policy principle to promote total life cycle environmental improvements of product systems by extending the responsibilities of the manufacturer of the product to various parts of the entire life cycle of the product, and especially the take-back, recycling and final disposal of the product.*"⁴² In India, the principle of Extended Producers Responsibility (EPR) has been an integral part of the waste management rules. The Batteries (Management and Handling) Rules (BMHR), 2001, was the first to be based on the concept of EPR without explicitly mentioning it. Thereafter, the rules made for plastic waste (Plastic Waste [Management and Handling] Rules, 2011) and e-waste (E-Waste [Management and Handling] Rules, 2011) explicitly laid down the provisions for EPR in managing waste.

The concept of EPR has received much-needed attention in the recent rules formulated for effective management of solid waste. It is one of the most important parts of the e- waste rules 2016 and Plastic Waste Management Rules, 2016. For the first time, it has also been included in the Solid Waste Management Rules, 2016 as well. Plastic Waste Management Rules, 2016, illustrates that the primary responsibility for collection of used multi-layered plastic sachet or pouches or packaging is of Producers, Importers and Brand Owners who introduce the products in the market. They need to establish a system for collecting back the plastic waste generated due to their products. There are different

approaches for successful implementation of EPR. Indore adopted a ward wise approach, and in one year achieved 100% segregation of waste at source from households and commercial establishments. The sorted waste is easily saleable to the recyclers. The recyclers are queuing up daily for collecting their category of waste with an assured quantity and quality.

- iii) ***Environment Impact Assessment (EIA) Notification:*** Initiated formally in 1994, the current EIA Notification 2006 lays out a detailed process for obtaining Prior Environment Clearance for any new projects or activities, or the expansion or modernisation of existing projects and projects seeking capacity addition with change in process or technology. Category A projects acquire their clearance from the Ministry of Environment, Forest and Climate Change (MoEFCC) while category B projects apply for clearances to the State Environment Impact Assessment Authority (SEIAA). Category B projects can be further broken down to B1 and B2, thereby determining which projects and activities will require an EIA before approval. Since January 2016, institutions have been created at the District level as well and they too have been included in the EIA Notification for approving certain instances of mining of minor minerals. These are the District Environmental Impact Assessment Authority (DEIAA) and District Level Expert Appraisal Committee (DEAC).

Since March 2016, Ministry of Environment, Forest and Climate Change, has adopted a new method of classifying each type of industry. A concept of 'white industries' has been introduced to denote 'non polluting' industries. They do not need permit or consent and just require to notify the relevant State Pollution Control Board. For other colour coded industries (red, orange, green) environmental permits are needed according to kind of activity and size of activity being conducted. A Pollution Index (PI) score is given to each industry, depending on utilization of resources, air emissions, hazardous waste generated, etc. (e.g., red category – PI score of 60 and above including but not restricted to asbestos, nuclear power plants, ship breaking, oil and gas extraction; orange category- PI score of 41 to 59 including food processing, pharmaceutical formulations; green category- PI score of 21 to 40 including sawmills, tyres/tubes retreading; white category- PI score upto 20 including wind power, mini hydel electric power less than 25 megawatts). No red category of industries shall normally be permitted in ecologically fragile area/protected area.⁴³

An integrated permit system can be submitted to relevant State Pollution Control Board to obtain consent to establish and consent to operate, authorisation under various Acts/Rules- submit a combined consent application to relevant SPCB/CPCB. In August 2018, a new online environmental portal was launched by MoEFCC named Parivesh which stands for Pro-Active and Responsive facilitation by Interactive, Virtuous and Environmental Single window Hub.- to facilitate online submission and tracking of various environmental clearance applications. It allows a single registration and single sign in for all types of clearances (environment, forest, wildlife, CRZ) and create a unique ID for each project.

There is a particular period for validity of various permits and most of consent orders, EC can be transferred.

- iv) ***Forest (Conservation) Act, 1980:*** The Forest (Conservation) Act, 1980 lays down the provisions that regulate the diversion of forestland for non-forest purposes. This is with the stated objective of ensuring long-term conservation of the forests in India, and reducing forest degradation. Any user agency (both government and non-government) has to seek prior permission from the Central Government before de-reserving any forest land, felling of trees or before diverting any forestland for non-forest use. The application for the same is moved through the Forest Department of the State Government, which is the final point of approval for forest diversion under this legislation. Non-forest use implies the breaking up or clearing of any forest land for the cultivation of tea, spices, rubber, palms, oil-bearing plants, horticultural crops or medicinal plants and for any purpose other than re-afforestation.

Proposals involving forest land upto 40 hectares (not including activities related to mining and encroachments) are handled by the regional office of the MoEFCC. Proposals involving forest land above 40 hectares and those related to mining and encroachments are handled by the MoEFCC.

- v) ***The Wildlife (Protection) Act, 1972:*** The Wildlife (Protection) Act, 1972, is a statute to provide for the protection of wild animals, birds and plants. It provides for declaration of national parks and sanctuaries and prohibits hunting and harm of wild animals and uprooting of specified plants in general.

A permit is required in case any activity including industrial, mining or infrastructure is likely to destroy, exploit or remove any wildlife including forest produce from a Protected Area. A Protected Area includes a Sanctuary, National Park, Conservation Reserve or a Community Reserve. It is also required in case an activity could destroy, damage or divert the habitat of any wild animal and in cases where activities are likely to divert, stop or enhance the flow of water into or outside the protected area. This is granted through the Chief Wildlife Warden only after the state government in consultation with the National Board for Wild Life (NBWL) is satisfied that such an action is necessary for the improvement and better management of the wild life. In case of non-compliance the permits can be cancelled and punishment can be imposed through imprisonment and/or fine.

12.4 IMPLEMENTATION, COMPLIANCE AND ENFORCEMENT

Good governance requires the establishment of viable institutions with adequate powers and competent personnel with the knowledge and means to deal with challenges while keeping public interest in mind. This is especially true in case of environmental pollution, which requires specialised scientific knowledge while dealing with various aspects of pollution.



Tata Institute of Social Sciences in a Report published in 2013 titled “Environmental Regulatory Authorities in India: An Assessment of State Pollution Control Boards” observed that,

“time and again across state governments have not been able to choose a qualified, impartial, and politically neutral person of high standing to this crucial regulatory post. The recent appointments of chairpersons of various State Pollution Control Boards like Karnataka (A a senior BJP leader), Himachal Pradesh (B a Congress party leader and former MLA), Uttar Pradesh (C appointed on the recommendation of SP leader X), Arunachal Pradesh (D a sitting NCP party MLA), Manipur Pollution Control Board (E a sitting MLA), Maharashtra Pollution Control Board (F a former bureaucrat) are in blatant violation of the apex court guidelines.”

Further, Supreme court in the case of *Techi Tagi Tara vs Rajendra Singh Bhandari*⁴⁴ highlighted that State Pollution Control Boards (or SPCBs) constituted under the Water (Prevention and Control of Pollution) Act, 1974 and the Air (Prevention and Control of Pollution) Act, 1981 possess only a few or sometimes none of the attributes of good governance and again a few or none of them are adequately empowered. It further stated, this is a serious problem afflicting the SPCBs for at least two decades (if not more).

Moreover, as per the NCRB data of 2020, a total number of 589 cases were registered under Water and Air Act throughout India. Further, under Environment Protection Act, a total number of 992 cases were registered all over India. Even though it's a substantial increase in the number of cases from 2019, still there is long way to go in order to ensure protection from environmental pollution and determining the liability of individuals and other such industries responsible for environmental pollution.

Thus, even though India has necessary provisions regarding protection of environment in the form of legislations and detailed rules, still issues regarding its implementation, compliance and enforcement have not been resolved entirely. Judicial forums in India have tried to resolve these issues to a certain extent.

12.5 JUDICIAL FORUMS ON ENVIRONMENTAL PROTECTION AND LIABILITY OF CORPORATES

The judicial forums in India, primarily the Supreme court and the National Green Tribunal have played an important role in providing environmental protection and determining the liability as well as damages for environmental wrongs.

i) Supreme Court:

Over the years Supreme Court has developed a rich jurisprudence pertaining to environmental law and policy in India. It has been the endeavour of this court to promote and imbibe the principles of International Environmental Law such as Precautionary Principle⁴⁵, Polluter pays principle⁴⁶ and Sustainable development⁴⁷ within the domestic jurisdiction and endorse environmental sustainability. The court has on several occasions directed the violators to pay hefty fines, which acts as a deterrent against future violations and also results in better enforcement of the law of the land.

The Hon'ble Supreme Court in the case of *Indian Council for Enviro-Legal Action v. Union of India*⁴⁸ stated that

“The polluter pays principle demands that the financial costs of preventing or remedying damage caused by pollution should lie with the undertakings which cause the pollution, or produce the goods which cause the pollution.....”

Similarly, in the case of *Vellore Citizens Welfare Forum v. Union of India*⁴⁹ the Hon'ble Supreme Court defined the polluter pays principle as:

“Polluter Pays principle has been held to be a sound principle. The Polluter Pays principle as interpreted by the Supreme Court means that the absolute liability for harm to the environment extends not only to compensate the victims of pollution but also the cost of restoring the environmental degradation. Remediation of the damaged environment is part of the process of “Sustainable Development” and as such the polluter is liable to pay the cost to the individual sufferers as well as the cost of reversing the damaged ecology. Apart from the constitutional mandate to protect and improve the environment there are plenty of post-independence legislations on the subject. In view of the constitutional and statutory provisions it must be held that Precautionary principle and the Polluter Pays Principle are part of the environmental law of the country.”

While dealing with varied environmental issues in the country, Supreme Court has never shied away from developing new principles of Liability in accordance with the changing times. On the issue of determining liability of enterprises engaged in hazardous or inherently dangerous activity in the case of *M.C Mehta v. Union of India*⁵⁰, Supreme Court developed the principle of Absolute Liability and refuted the rule of Strict Liability as adopted in the case of *Ryland v. Fletcher*. The court stated that,

“an enterprise which is engaged in a hazardous or inherently dangerous industry which poses a potential threat to the health and safety of the persons working in the factory and residing in the surrounding areas owes an absolute and non-delegable duty to the community to ensure that no harm results to anyone on account of hazardous or inherently dangerous nature of the activity which it has undertaken”

Further, in the case of *Indian Council for Enviro Legal Action Vs. Union of India*⁵¹, the Court examined the grave pollution of a village, caused by the trial run of certain ‘rogue’ industries, and held that it was a case where principle of absolute liability for damages shall be applied.

Moreover, in the case of *Kamal Nath v. Union of India*⁵² while adopting public trust doctrine, Supreme Court highlighted the difference between damages and exemplary damages that offenders are required to pay and imposed a fine of Rs. 10 lakh as exemplary damages. It stated that,

“A person who is guilty of causing pollution has to pay damages (compensation) for restoration of the environment and ecology. He has also to pay damages to those who have suffered loss on account of the act of the offender. In addition to damages aforesaid, the person guilty of causing pollution can also be held liable to pay exemplary damages so that it may act as a deterrent for others not to cause pollution in any manner. The considerations for which fine can be imposed upon a person guilty of committing an offence are different from those on the basis of which exemplary damages can be awarded.”

Thus, the apex court and the High Court can and do impose exemplary damages for causing harm to environment. In *Sterlite Industries case* (2013), the copper smelter plant was found to be operating without a valid renewal of its environmental consent to operate. The Supreme Court in assessing the company’s liability to pay damages reviewed the company’s annual report and determined that 10% of profit before depreciation, interest and taxes (PBDIT) had to be paid which amounted to INR 1 billion.

In its effort to promote environmental justice in India, Supreme Court delivered a landmark judgement⁵³ wherein it was argued that statutory tribunal like NGT does not have suo moto powers as only constitutional courts can exercise it. However, court while stressing on the importance of NGT in dealing with environmental issues in this contemporary era stated that,

“NGT was conceived as a specialized forum not only as a like substitute for a civil court but more importantly to take over all the environment related cases from the High Courts and the Supreme Court. Many of those cases transferred to the NGT, emanated in the superior courts and it would be appropriate thus to assume that similar power to initiate suo motu proceedings should also be available with the NGT.”

ii) National Green Tribunal:

NGT was established as a statutory tribunal in year 2010, with the objective to make environmental justice accessible, effective and expeditious in India. Since its inception it has played an important role in determining the liability of wrongdoers and providing swift justice to the aggrieved parties.

Realising the lack of enforcement of environmental framework and the unwillingness of State Pollution Control Boards to act against industries and other such perpetrators, NGT in the case of *Paryavaran Suraksha Samiti & Anr. Vs. Union of India & Ors.*⁵⁴ vide order dated 03.08.2018 stated that-

“The Central Pollution Control Board may take penal action for failure, if any, against those accountable for setting up and maintaining STPs, CETPs and ETPs. Central Pollution Control Board may also assess and recover compensation for damage to the environment and the said fund be kept in a separate account and utilized in terms of an action plan for protection of the environment.”

Further, in the case of *Praveen Kakar & Ors v. Ministry of Environment & Forests & Ors.*⁵⁵ vide Order dated 08.01.2019 the Tribunal stated that,

“the Pollution Control Board had failed to perform its duties in taking statutorily mandated coercive measures under Section 31A of the Air (Prevention and Control of Pollution) Act, 1981 and 33A of the Water (Prevention and Control of Pollution) Act, 1974 or initiating prosecution. This Tribunal directed CPCB to exercise its statutory powers to determine and recover damages for violation of environmental norms by the respondent therein.”

In view of the directions issued by the NGT, CPCB has started maintaining an Environmental Compensation Fund. It has also constituted a committee, in order to manage the said fund.

Further, specific guidelines on calculation of Environmental Compensation to be imposed on perpetrators have been issued in line with the orders of NGT.

It is to be noted that penalties have been drastically increased under NGT Act. Under Section 26(1) of the Act, the tribunal can award punishment upto 3 years or fine upto 10 crores for non compliance of order of NGT.

Thus, the proactive nature of NGT with respect to the preservation and conservation of Environment in India, has led to the development of a practical regime of fines and environmental compensation in line with polluter pays principle, for various types of offences such as illegal mining, wrongful disposal of waste including hazardous waste, air pollution, water pollution etc. It has resulted in better enforcement of environmental laws and has acted as an effective deterrent against future violations.

12.6 CLIMATE CHANGE AND INDIA

India launched its National Action Plan on Climate Change in 2008. India has been a leading host country of Clean Development Mechanism investments, enabling Annex 1 countries to invest in emission reducing projects (thereby earning certified emission reductions). India has emerged as second largest beneficiary to China in CDM projects. Its share in CDM projects is around 20% (China is 50%) and share in CERs is 13% (China is 60%). The opportunities of CDM in energy sector, electric vehicles sector are many.

India submitted its Intended Nationally Determined Contribution in October 2015 which gives an outline of post 2020 climate actions that the country shall take. India is a founder member of International Solar Alliance launched in 2015 itself. Recently, at COP 26, India made announcement of new climate action targets and has indicated that it shall be carbon neutral by 2070.

12.7 SCHEMES, FISCAL POLICIES, AND MARKET-BASED MEASURES

India is one the fastest growing economies of the world. Indian government has initiated several measures in the form of policies, schemes etc in order to promote sustainable production, consumption and also providing better and clean technologies to industries. Some of these are:

a) *Perform, Achieve and Trade (PAT) Scheme*

It is a flagship programme of Bureau of Energy Efficiency under the National Mission for Enhanced Energy Efficiency (NMEEE). PAT is a multi-cycle program started in 2012, with the objective to reduce the specific energy consumption in the most energy-intensive industries in the country. While the legal standing was built through the amendment of the Energy Conservation Act 2001, the operational artifacts were largely built around the principles of market-based mechanisms. It identifies sectors and designated consumers within such sectors and awards overachieving consumers with Energy saving certificates which could then be traded on Indian Energy Exchange.⁵⁶

b) *Green Bonds*

Green bonds are the bonds issued by any sovereign entity, inter-governmental groups or alliances and corporates with the aim that the proceeds of the bonds are utilised for projects classified as environmentally sustainable. As of February 12, 2020, the outstanding amount of green bonds in India was US\$16.3 billion. India issued green bonds of about US\$8 billion since January 1, 2018, which constituted about 0.7 per cent of all the bonds issued in the Indian financial market. Although the value of green bonds issued in India since 2018 constituted a very small portion of the total bond issuance, India maintained a favourable position compared to several advanced and emerging economies.

c) *Securities and Exchange Board of India (SEBI)*

In 2012, SEBI mandated the top 100 listed entities by market capitalisation to file Business Responsibility Reports (BRR) as part of their annual report, as per the disclosure requirement emanating from the 'National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business' (NVGs). The requirement for filing BRRs was progressively extended to the top 500 listed entities. Further on March 25, 2021, SEBI has introduced *Business Responsibility and Sustainability Report*, which requires top 1000 listed entities (by market capitalization) to mandatorily disclose-resource usage, air emissions, waste management and compliance with EPR and PAT scheme.⁵⁷

d) *Micro, Small and Medium Enterprises (MSME)*

MSME sector in India is one of the largest contributors to manufacturing, provides employment to millions of people and is considered to be the backbone of our economy. However, most of the industries in this sector are still using first generation technologies which result in high pollution levels and low productivity. In order to promote new and green technologies in this sector government has adopted several schemes and policies such as:

- ***Zero Defect Zero Effect (ZED) Certification Scheme:*** It is an extensive drive to create proper awareness in MSMEs about ZED manufacturing and motivate them for assessment of their enterprise for ZED and support them. After ZED assessment, MSMEs can reduce wastages substantially, increase productivity, expand their market as IOPs, become vendors to CPSUs, have more IPRs, develop new products and processes etc.
- ***Scheme for Promoting Innovation, Rural Industry & Entrepreneurship (ASPIRE):*** It was launched to set up a network of technology centres and incubation centres to accelerate entrepreneurship and promote start-ups for innovation in agro industry.
- ***Credit Linked Capital Subsidy for Technology Up gradation (CLCSS):*** The objective of the Scheme is to facilitate technology up-gradation in MSEs by providing an upfront capital subsidy of 15 per cent (on institutional finance of upto Rs 1 crore availed by them) for induction of well-established and improved technology in the specified 51 sub-sectors/products approved.

12.8 IMPORTANT DEVELOPMENTS

Concept of Corporate Social Responsibility- The 2013 amendment to the Companies Act introduced the significant concept of CSR as a practical regulatory measure but nothing concrete was referred to environmental protection that emerged as a nominal component. There needs to be efforts made to develop a supplementary concept of Corporate Environmental Responsibility in India.

Environmental Audit- is not mandatory but some states as Gujrat, Maharashtra and Karnataka offer incentives to industrial units obtaining an ISO certification. The incentives are longer validity period of consent/authorisation, expeditious clearance of renewal applications etc. These efforts need to be coordinated at the national level to provide the necessary catalyst to develop sustainably.

12.9 SUMMARY

In the past fifty years the world has developed ample understanding on the relationship between human beings and environment. The Stockholm Declaration adopted at the United Nations Conference on Environment in Stockholm, 1972, placed environmental issues at the forefront of international concerns and marked the start of a dialogue between industrialized and developing countries on the link between economic growth, the pollution of the air, water, oceans and the well-being of people around the world.

India's approach towards environmental protection was piecemeal and reactive in nature. In response to Stockholm declaration 1972, Air (Prevention and Control of Pollution) Act, 1981, and Water (Prevention and Control of Pollution) Act, 1974, were introduced. Further, Art 48 A and 51(g) were incorporated in Indian Constitution by way of 42nd amendment in 1976.

The judicial forums in India, primarily the Supreme court and the National Green Tribunal have played an important role in providing environmental protection and determining the liability as well as damages for environmental wrongs.

India is one the fastest growing economies of the world. Indian government has initiated several measures in the form of policies, schemes etc in order to promote sustainable production, consumption and also providing better and clean technologies to industries.

12.10 SELF ASSESSMENT QUESTIONS

- 1) What are the key constitutional provisions in India relating to Environment?
- 2) Write a brief note on International Developments in the field of Environmental Law and its impact on Businesses and Industries?
- 3) What are the important provisions of Water Act, 1974 and Air Act 1981?
- 4) What is the concept of Extended Producer's Responsibility?
- 5) Describe the major schemes that have been specially implemented for the MSME sector?
- 6) Briefly discuss how the concept of sustainable development is being implemented in India?

12.11 REFERENCES

- ¹ Para 45 and 46, General debates, Report on the Conference of Human Environment, 1972
- ² United Nations General Assembly, 1987, p. 43
- ³ Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation
- ⁴ Ensure sustainable consumption and production patterns
- ⁵ Kyoto Protocol established flexible market-based mechanisms namely International emissions trading, clean development mechanism and joint implementation in order to help the countries to achieve their targets.
- ⁶ Art. 9 Paris Agreement- reaffirms the obligations of developed countries to support the efforts of developing country Parties to build clean, climate-resilient futures, while for the first time encouraging voluntary contributions by other Parties.
- ⁷ As per World Bank study released in 2016, India lost more than 8.5% of its GDP in 2013 due to the cost of increased welfare and lost labour due to air pollution.
- ⁸ Climate Investment Opportunities in South Asia: An IFC Analysis, 2017 pg. 4

- ⁹ Nina Chestney, *Global Extraction of Primary Materials to Triple by 2050 - UNEP, RUETERS*
- ¹⁰ M.C Mehta v. Union of India AIR 1992 SC 382(court directions to broadcast and telecast ecology programmes on the electronic media and include environmental study in school and college curriculum)
- ¹¹ S. Jagannath v. Union of India AIR 1997 SC 811(directions prohibiting non-traditional aquaculture along the coast): M.C Mehta v. Union of India AIR 1996 (2) SCALE 92 (court directions for the introduction of unleaded petrol vehicles)
- ¹² T.N Godavarman Thirumulkpad v. Union of India AIR 1997 SC 1228 (judicial supervision over the implementation of national forest laws): M.C Mehta v. Union of India 1992(Supp.2) SCC 633 (directions in the Ganga Pollution Case to riparian industries, tanneries and distilleries regarding abatement of pollution)
- ¹³ Law Commission of India, Proposal to Constitute Environmental Courts, Report No. 186 (September 2003)
- ¹⁴ M.C. Mehta v. Union of India, 1986 (2) SCC 176; Indian Council for Enviro-Legal Action v. Union of India, 1996 (3) SCC 212; A.P. Pollution Control Board v. M.V. Nayudu, 1999 (2) SCC 718.
- ¹⁵ See,
 - Aryavart Foundation Versus M/s Vapi Green Enviro Ltd. &Ors. (Original Application No. 95/2018);
 - News item published in “The Times of India” Authored by Shri Vishwa Mohan Titled “NCAP with multiple timelines to clean air in 102 cities to be released around August 15”(Original Application No. 681/2018);
 - Westend Green Farms Society Versus Union of India & Ors. (Original Application No. 400/2017);
 - News item published in “The Asian Age” Authored by Sanjay Kaw Titled “CPCB to rank industrial units on pollution levels” (Original Application No. 1038/2018)
 - Compliance of Municipal Solid Waste Management Rules, 2016 (OA 606/2018)
- ¹⁶ Art. 48A- ‘the state shall endeavour to protect and improve the environment and to safeguard the forests and wild life of the country’. Also entries 17(A) and 17 (B) (protection of wild animals and birds) have been added to the concurrent list.
- ¹⁷ Art 51A (g)- it shall be the duty of every citizen of India to protect and improve the natural environment including forests, lakes, rivers, wildlife and to have compassion for living creatures.
- ¹⁸ (1995) 2 SCC 577
- ¹⁹ *MC. Mehta v. Union of India*, AIR 1987 SC 1086(Ind.) (Popularly known as ‘Oleum Gas Leak Case).
- ²⁰ *Subhash Kumar v. State of Bihar*, (1991) 1 SCC 598
- ²¹ *MC. Mehta v. Union of India*, (1998) 6 SCC 60
- ²² *A.P. Pollution Control Board II case* (2006) 6 SCC 543(Ind.), *Narmada Bachao Andolan v. Union of India*, (2000) 10 SCC 664

- 23 AIR 1998 Cal. 121
- 24 Section 24, Water (Prevention and Control of Pollution) Act 1974
- 25 Section 20, Water (Prevention and Control of Pollution) Act 1974
- 26 Section 21, Water (Prevention and Control of Pollution) Act 1974
- 27 Section 23, Water (Prevention and Control of Pollution) Act 1974
- 28 Section 47, Water (Prevention and Control of Pollution) Act 1974
- 29 Section 25, Water (Prevention and Control of Pollution) Act 1974
- 30 AIR 2013 Pat 70
- 31 Section 22 Air (Prevention and Control of Pollution) Act 1981
- 32 Section 25 Air (Prevention and Control of Pollution) Act 1981
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- 34 Section 26 Air (Prevention and Control of Pollution) Act 1981
- 35 Section 40 Air (Prevention and Control of Pollution) Act 1981
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- 37 2003 (7) Scale 475
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- 41 Section 26 EPA, 1986
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- 48 Para 67 of [(1996 AIR SCW 1069)].
- 49 Para 11-14 (1996 5 SCC 647)
- 50 AIR 1987 S.C. 1086
- 51 Refer Para No.70, Supra note 42
- 52 Para 24 of 2002 (2) SCALE 654
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- 54 Original Application No. 593/2017
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- 56 UNLEASHING MARKET-BASED APPROACHES TO DRIVE ENERGY EFFICIENCY INTERVENTIONS IN INDIA: AN ANALYSIS OF THE PERFORM, ACHIEVE, TRADE (PAT) SCHEME, ADB Working paper series no. 1177, August 2020
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UNIT 13 COMPETITION LAW

Objectives

After studying this unit, you should be able to:

- Understand the Objectives of Competition Law and Brief Historical Overview of Indian Competition Law
- Describe Monopolies and Restrictive Trade Practices Act, 1969, and Competition Act, 2002
- Appreciate different Anti-competitive Agreements and Vertical Agreements
- Explain the different Enforcement Authorities of Competition Law

Structure

- 13.1 Introduction
- 13.2 Objectives of Competition Law
- 13.3 Brief Historical Overview of Indian Competition Law
- 13.4 Monopolies and Restrictive Trade Practices Act, 1969
- 13.5 Raghavan Committee Report
- 13.6 Competition Act, 2002
- 13.7 Anti-competitive Agreements
- 13.8 Vertical Agreements
- 13.9 Relevant Market
- 13.10 Abuse of Dominance
- 13.11 Mergers and Combinations
- 13.12 Enforcement of Competition Law
- 13.13 Summary
- 13.14 Self-Assessment Questions
- 13.15 Further Readings/References

13.1 INTRODUCTION

Competition law, which is also referred to as antitrust law in some jurisdictions, plays a pivotal role in ensuring smooth functioning of a dynamic market economy. Competition law takes diverse measures and approaches for ensuring fair competition among firms, which in turn can augment customer welfare by offering quality products at lowest possible prices. Fair competition in markets is important for all, be it the consumers, the competing firms, and the economy.

13.2 OBJECTIVES OF COMPETITION LAW

Competition law concerns itself with firms enjoying undisputed market power, which opens up the possibility of hindering consumer welfare by increasing prices, reducing output, diminishing product quality and suppressing innovation.¹ Competition law also keeps a check on the possibility of business firms from colluding with each other, affecting the supply of a product or a service, thereby proving detrimental for the consumers. The basic assumption is that markets

populated by a few participants may prove to be less competitive than markets housing multiple participants, as oligopolistic and monopolistic enterprises can exert their dominance to hinder the entry of new participants.²

13.3 BRIEF HISTORICAL OVERVIEW OF INDIAN COMPETITION LAW

The Indian Constitution has been drafted carefully with several measures aimed at safeguarding diverse rights that can contribute to the flourishing of the country as well as its citizens. Articles 38 and 39, though having been placed in part IV of the Constitution as Directive Principles of State Policy and unenforceable in a court of law, have proven extremely significant in laying down directions for good governance of a State. They direct the State to frame policies for ensuring that the ownership and control of the material resources are adequately distributed, and that the operation of the economic system does not lead to a concentration of wealth to the common detriment.³

The first phase of market regulation in India began in 1950-1951, which was characterized by an increased reliance on the government to take the initiative in economic activities. Also known as the closed economy model, policies at that time were less focused on ensuring competition and more on the prevention of concentration of economic power. The Government of India ordered the formation of a committee, the Mahalanobis Committee, to assess the income distribution in the society owing to rising monopolistic and restrictive trade practices in the country. This led to the formation of the Monopolies Inquiry Committee and, the report submitted by the former paved the way for the Monopolies and Restrictive Trade Practices Act, 1969 (MRTP Act). This way, the Constitution of India, specifically Article 39, sowed the seeds for the genesis of competition laws in India.⁴

13.4 MONOPOLIES AND RESTRICTIVE TRADE PRACTICES ACT, 1969

The MRTP Act was enacted to control monopolies, to ensure that the economic system does not culminate in concentration of economic power and, to disallow monopolistic and restrictive trade practices.⁵ What highlighted the second phase, ranging from 1991 to present, was bringing forth market-oriented economic policies with the coming of the New Economic Policy (NEP), that needed to be in tune with the rise of globalization, liberalization and privatization policies.⁶ These policies led to de-licensing and deregulation of sectors, that were priorly under the control of the public sector. Industrial activities which were exclusively operated by the public sector were opened up for entry by the private sector. The MRTP Act was observed to be incompatible with this shift in industrial policies, which focused on competition and market orientation. Thus, arose the need for a regulator which could facilitate market functioning in accordance with the country's changing industrial policies.⁷

13.5 RAGHAVAN COMMITTEE REPORT

The call seeking a shift of focus from restraining monopolies to the promotion of competition was one of the primary reasons for the MRTP Act becoming obsolete,

thereby paving way for a new legislation.⁸ What ensued was the appointment of a High-Level Committee on Competition Policy and Law in 1999, often referred to as the “Raghavan Committee”.⁹ The Committee was responsible for providing suggestions for the establishment of a suitable legislative framework for competition law and recommended changes in relation to restrictive trade practices. The Committee, in its final report submitted to the Government in May 2000, highlighted the need for a Competition Policy to attain efficient allocation of resources, to regulate concentration of economic power and to promote consumer welfare.¹⁰ It was submitted that Competition Policy has its primary economic goal as the preservation and promotion of competition, which can further contribute in making the process of production and allocation of goods structured and more efficient.¹¹ The Committee pressed on the need to balance the conflict between the existing government policies and the competition policy and, highlighted the requirement for a law and a law enforcement authority in the form of Competition Act and Competition Commission of India (referred as CCI or Commission hereinafter), respectively.¹²

13.6 COMPETITION ACT, 2002

The Competition Act was enacted in 2002, based on the recommendations of the Raghavan Committee for ensuring fair competition and ushering economic development in the country. The primary aim of this piece of legislation is to avert practices having anti-competitive effects, for the advancement of competition in the markets, to safeguard the interests of the consumers and, to guarantee freedom of trade to the market participants. This legislation is the successor to Monopolies and Restrictive Trade Practices Act, 1961. The Act lays down provisions relating to horizontal and vertical anti-competitive agreements having an adverse effect on competition, prohibition of abuse of dominance, and rules for combinations and their regulation. The Competition Act also contains certain provisions to promote competition advocacy.

13.7 ANTI COMPETITIVE AGREEMENTS

Agreements entered between enterprises, persons, or association of enterprises or persons in pursuance of production, distribution, supply, storage or control of products or services, which have a tendency to result in Appreciable Adverse Effect on Competition (AAEC) within the jurisdiction are referred to as anti-competitive agreements¹³ and they shall be declared void.¹⁴ To determine if an agreement has an appreciable adverse effect on competition, the Commission shall have due regard to factors including, creation of barriers to new entrants, driving off existing competitors, foreclosure of competition by hindering entry, improvement of production or distribution of goods, etc.¹⁵

In a competitive market set-up, firms vying for the business or the consumers are supposed to compete with one another, not collude and cooperate to alter the process of competition. Cartels are horizontal agreements made for the purpose of market allocation, price fixing, output restriction and, the submission of collusive tenders to rig the outcome of competitive tenders are some of the techniques employed by conniving firms to distort competition.¹⁶

Under the Competition Act, 2002, section 2(c) puts forth an inclusive definition of ‘cartel’, as “an association of producers, sellers, distributors, traders or service

providers who, by agreement amongst themselves, limit, control or attempt to control the production, distribution, sale or price of, or, trade in goods or provision of services.” In the *cartelization by public sector insurance companies*¹⁷ case, the CCI took suo motu cognizance to investigate if four public sector insurance companies had formed a cartel and engaged in bid-rigging in response to a tender issued by the Kerala Government. Rejecting the argument of the insurance companies that they formed a single economic entity and were thus subject to the control of the central government, the CCI held that the submission of separate bids by the companies for the tender, along with the resolution regarding determination of bid amounts being taken voluntarily through an internal meeting without the supervision by the Finance Ministry, proved the contrary. Based on the business sharing agreement and the evidence of the Opposite Parties (OPs) having met one day before the submission of tender, the CCI held that there was a conclusive proof of bid rigging and collusive bidding by the OPs, satisfying the requirements for contravention under section 3(3)(d) of the Competition Act.

Any agreement entered or decision taken amongst enterprises, persons, association of enterprises or persons or, between a person and an enterprise, including cartels, shall be presumed to have an appreciable adverse effect on competition and shall be considered anti-competitive per se, if they result in the following:¹⁸

a) Determination of sale prices:

The competition regulatory framework not only concerns itself with blatant price fixing, but also agreements having an effect on suppressing price competition. In other words, the act of price fixing does not just encompass the final price but also instances having an indirect impact on the final price.

Reducing price competition by agreeing not to offer discounts, making use of an open information scheme and, charging uniform delivered prices may also be instances of price fixing.¹⁹ Market participants forming a cartel, agreeing to offer identical discounts and applying the same in the downstream market was also held to be another facet of price fixing and declared to be anticompetitive in nature.²⁰

b) Output control

An agreement among firms to control or limit production, supply, technical progress, markets or provision of goods and services shall be presumed to be anticompetitive.²¹ The CCI generally focuses on factors such as production capacity, capacity utilization of the competitors, demand for the product in question to decipher any patterns of output control for the concerned product.²² In the *Cement Cartel*²³ case, the Commission found evidences regarding the formation of understanding and agreement among the Opposite Parties (OPs) via the Cement Manufacturing Association(CMA) for communicating and information sharing in relation to manufacture of cement. The Commission also unearthed low-capacity utilization leading to controlled supply of cement by the companies, which was in clear contravention of section 3(3)(b) of the Competition Act. The commission opined that limiting the supplies of cement over the course of years and giving rise to shortages had led to an upward demand, resulting in a hike in prices thereafter. In the absence of any efficiency or improvement in manufacture owing to the coordinated behavior of the cement manufacturing companies, the OPs were held to have formed a cartel.

Recently, the CCI passed a final order against three beer companies, viz., United Breweries Limited, SABMiller India Limited (renamed as Anheuser Busch InBev India Ltd.) and, Carlsberg India Private Limited for forming a cartel and selling beer in many States and Union Territories, in conjunction with the All-India Brewers' Association. The cartel had engaged in price parallelism which was in contravention of Section 3(3)(a) of the Competition Act, 2002.²⁴

c) Market allocation

Competition may also be threatened by an agreement between the firms to apportion segments of market amongst themselves, to be handled exclusively by each seller such that they no longer have to compete with each other. When the participating firms concur to share particular markets based on geographical area, classes of customers or, on the basis of the product, such agreements may be referred to as horizontal market sharing agreements.²⁵ In *HFB Holding v. Commission*, the opposite parties were penalized for forming a cartel and indulging in sharing of the entire European market among themselves. They further engaged in acts to hinder the only substantial competitor not forming a part of the cartel, driving it away from the concerned market.²⁶

d) Bid rigging or collusive bidding

Agreements capable of lessening or wiping off competition for bids or, which have the effect of manipulating the process of bidding are held to be anticompetitive per se. Bid rigging or collusive tendering is said to occur when competing bidders decide not to compete genuinely, or endeavor to secretly influence the outcome of a bidding process by submission of identical or cover bids.²⁷

In the case of *cartelization in tenders of Pune Municipal Corporation for Solid Waste Processing*²⁸, a *prima facie* opinion was formed by the CCI against the OPs for having engaged in the acts of bid rigging or collusive bidding violating Section 3(3)(d) of the Competition Act, 2002. The CCI opined that bid rigging under Section 3(3)(d) shall be presumed to have an adverse effect on the competition irrespective of the purpose or duration of the cartel and, it is immaterial if the act culminated in a benefit being accrued from the cartelization. The CCI also held that so long as a subset of bidders are found rigging the bidding process by colluding, the onus shall shift on the OPs to rebut the presumption of having caused an AAEC. Disagreeing with the contention of the OPs that the latter were engaged in different business activities at the time of the bidding process, and thus not amenable under section 3, the commission held that the activity for which bidding was held and in pursuance of which the alleged violation of law took place is what proves significant in determination of cartels.

13.8 VERTICAL AGREEMENTS

Vertical agreements are agreements between persons or enterprises at different levels of the production chain in distinct markets in relation to production, distribution, supply, storage or price of goods or provision of services.²⁹ Unlike horizontal agreements, vertical agreements are not anti-competitive per se, and it needs to be established that the alleged activity has caused an appreciable adverse effect on competition (AAEC) in the country.³⁰ Vertical agreements also comprise the following:

i) Tie-in arrangement

Tying is the practice of supplying a product, the tying product, while also making the buyer purchase a second product, known as the tied product. Tying may be employed by a dominant firm for increasing the sales of the tied product in the market by leveraging its position with respect to the tying product, leading to a horizontal foreclosure of market.³¹ A tie-in arrangement is detrimental for competition as a consumer is coerced into purchasing a product (the tied product) which she or he may not necessarily require.³² In ***Hilti AG v. Commission***, Tetra Pak, a company engaged in the sale of liquid packaging machines, required customers to also buy cartons from it, further insisting that services for repair and maintenance should be provided by them. The Commission opined that sale of cartons along with the machines was not customary, with the former forming a separate market upon which Tetra Pak was trying to eliminate competition.³³

ii) Exclusive supply agreement:

Agreements restricting the buyer from purchasing goods or services other than those of a particular supplier are termed as exclusive supply agreements. Such agreements can also be referred to as exclusive purchasing or single branding agreements. By employing such agreements, the purchaser is barred from acquiring products from other competing sellers, defeating the process of market competition.³⁴ In ***Jindal Steel & Power Ltd. v Steel Authority of India Ltd.***, it was alleged that the agreement between Steel Authority of India Limited (SAIL) and Indian Railways (IR) for exclusive supply of rails to IR was anti-competitive, resulting in foreclosure of market for new entrants, including Jindal Steel. The Commission held that the exclusive arrangement between SAIL and IR was not in violation of the provisions of competition law, as only a small segment of SAIL's total sales made up the sales to IR. Also, IR required assurances for steadiness of supply of long rails which was being offered by SAIL, with Jindal having failed to establish itself as a viable competitor to SAIL.³⁵

iii) Exclusive distribution agreement:

Agreements requiring the supplier to sell its goods to one specific distributor in a particular territory, thereby restricting the output or supply of any products, falls under the category of exclusive distribution agreements. These may diminish intra-brand competition and heighten the risks of market partitioning or market allocation for the sale of goods, facilitating price discrimination.³⁶

iv) Refusal to deal:

Refusal to deal refers to scenarios wherein restrictions are placed on persons or classes of persons to whom goods may be sold or from whom the goods may be bought.³⁷ Refusal to deal agreements result in market foreclosure for new entrants, making it difficult for the latter to compete. In ***English Welsh & Scottish Railway Ltd. v. E. ON UK plc***, the railway company was fined for entering into exclusive agreements with various power stations for the carriage of coal.³⁸

v) Resale price maintenance:

Resale Price Maintenance occurs when a seller (mostly, manufacturer) demands that the buyer (mostly retailers) should engage in resale of that good only at a price fixed by the seller and the buyer cannot resell at prices lower than the prices suggested by the seller. In *Fx Enterprise Solutions India Pvt. Ltd v. M/s Hyundai Motor India Limited* ³⁹, the CCI found Hyundai Motors placing restrictions on its dealers by imposing a maximum permissible discount at which the vehicles may be sold to an end-consumer. Dealers not adhering to the upper limits on discount prices were being penalized. The CCI held that the imposition of minimum resale price prevents the dealers from effectively competing on the price factor, and is anti-competitive in nature.

Section 3(5) of the Competition Act holds that such agreements shall not affect the rights of any person to restrain infringement or, from laying down reasonable conditions imperative to protect her or his intellectual property rights, including patents, copyright, trademarks, designs, and geographical indications.

13.9 RELEVANT MARKET

Under the statutory framework of the Competition Act, the delineation of a relevant market is of utmost significance. For an abuse of dominance investigation, an enterprise shall be considered dominant only if it has attained a position of strength in the relevant market. Determination of a relevant market is also significant in a combination analysis, where the CCI has to ensure that the proposed combination does not result in appreciable adverse effect on competition. In the case of *Competition Commission of India (CCI) v. Coordination Committee of Artists and Technicians of West Bengal Film and Television Industry*, the Supreme Court had held that the delineation of relevant market is not a necessary precondition for investigations under Section 3 of the Act, as there is a presumption of AAEC in an agreement between market participants under that provision.

Relevant market may be determined by the CCI with respect to the relevant product market or the relevant geographic market or with regards to both.⁴⁰ Relevant product market is referred to as a market with products or services considered interchangeable or substitutable by a consumer due to factors such as characteristics of the products, price, or use.⁴¹ In the case of *In Re Matrimony.com and Google*, Google was charged with abusing its dominant position by granting preference to its own services and its verticals by manipulating the search results. The relevant market in this case was delineated to be - the market for online web search services in India and, the market for online search advertising in India. This was done by differentiating between offline and online sections of advertising, on the basis that they are not substitutable.⁴² Relevant geographic market is referred to a market comprising the area where the conditions of competition for supply of goods or provision of services are distinctly homogeneous and can be differentiated from the conditions existing in the adjacent areas.⁴³ In *Re Harshita Chawla and Others*, since conditions for the functionality of OTT messaging apps through smartphones were found to be homogeneous throughout India, the entire geographic area of India was delineated to be the relevant geographic market.⁴⁴

13.10 ABUSE OF DOMINANCE

Under Competition law, mere dominance exerted by a firm is neither considered bad nor held punishable. However, the abuse of its dominance by an enterprise merits investigation by the competition authorities. This is in contrast with the earlier legislative framework, as under the erstwhile MRTP Act, violation was gauged based on the size of an enterprise, rather than the abusive conduct of the latter.⁴⁵

An enterprise is said to be in a dominant position, when it is able to operate independent of other competitive forces existing in the relevant market and has the power to affect the consumers or its competitors in its favour.⁴⁶ Competition law makes abuse of dominance by an enterprise punishable under law. Some of the acts considered to be an abuse of dominant position includes, imposing of conditions or prices which are unfair or discriminatory either through direct or indirect means (which includes price discrimination and predatory pricing) and, restricting the production of goods or provision of services.⁴⁷ The Commission seeks to capture conduct which may be exploitative (wherein the acts of the enterprise prove detrimental to the consumers in the form of rise in prices, reducing output or imposition of other unfair terms and conditions) and, exclusionary (affecting the competitors of the dominant firm through the acts of exclusive dealing, margin squeezing, denying market entry etc. to name a few).

In the case of *European Union v. Google*, also known as Google Search (shopping) case, Google was fined €2.42 billion by the European Commission for abusing its dominance in the general search market, and stifling market competition by granting primacy to its own vertical comparison-shopping services. It was held that Google's self-preferencing conduct had foreclosed competition in the shopping services market, which represented a separate market from the search market. Leveraging its position in the general search market, Google had resorted to bumping down other rival sites down the list, distorting competition.⁴⁸

The three important steps required in every abuse of dominance investigation are as follows:

- Determination of the relevant market.
- Determining if the enterprise is dominant in the relevant market.
- If found dominant, investigating whether the dominant entity has engaged in acts falling under the purview of abuse of dominance.

The CCI, while inquiring into the dominance of an enterprise, shall consider the factors provided under Section 19(4) of the Competition Act, which include market share, size and resources, countervailing buyer power, market structure, and dependence of consumers.⁴⁹

Section 4 of the Indian Competition Act also takes into account the use of dominance in one market to enter into another relevant market. In the case of *Harshita Chawla and WhatsApp*⁵⁰ the issue was whether WhatsApp was using its dominance in the relevant market of internet based instant messaging apps to gain entry into another relevant market, being Unified Payments Interface (UPI) digital payments app market (WhatsApp Pay), which was aided by pre-installation

of WhatsApp on mobile phones. The Commission, post investigation, held that there was no abuse of dominance as the users were allowed discretion before usage of the payment app along with separate registration requirements (terms and conditions) prior to initiation of services.

13.11 MERGERS AND COMBINATIONS

One of the significant business developments in the field of corporate law has been a plethora of transactions encompassing mergers and acquisitions. The rationale behind companies opting to merge may range from increasing market power, economies of scope, economies of scale, synergistic gains, eliminating competition, obtaining access to R&D and technological knowhow.

Competition law is entrusted with the task of scrutinizing mergers that have a potential for undermining competition. While assessing a merger, the competition authorities investigate if the merger will generate horizontal effects (effects borne out of mergers between actual or potential competitors at the same level of the production chain and dealing with the same product or geographic markets), vertical effects (effects occurring as a result of merger between enterprises operating in different albeit complementary stages or levels in the market for the same final product)⁵¹ or, conglomerate effects (effects originating due to mergers, which is neither functionally vertical or horizontal, but enables the merged entity to foreclose competition in two distinct but related/unrelated markets by exercise of its market power.⁵²

Merger control, as a means to keep a check on the market power of dominant firms on an ex-ante basis, is essential to preserve competitive market structures and for achieving pro-competitive effects for the consumers.⁵³ A complicated element of merger control is that its role is forward looking in nature, focusing on whether a proposed merger will lead to detrimental effects on competition in the future.⁵⁴ Numerous theories of competitive harm have been brought forth to highlight the negative impact of a merger on consumer welfare, which includes unilateral effects (resulting entity of a merger exercising market power post-merger)⁵⁵, coordinated effects (resulting entity of a merger able to harmonize competitive behaviour with other firms in the market), vertical effects and conglomerate effects.⁵⁶ Competition authorities conduct merger assessment by weighing the pro-competitive effects of a combination on the market against the anti-competitive ramifications if the merger is allowed to be consummated.

Under the Indian Competition Act, Sections 5 and 6 are the significant provisions regulating combinations, encompassing corporate restructuring methods such as mergers, acquisitions & amalgamations. According to these provisions, enterprises or persons choosing to enter into combinations crossing the specified assets or turnover thresholds mentioned in Section 5 have to inform the CCI, divulging the details of the proposed combination.⁵⁷ A combination likely to result in an AAEC within the relevant market shall be void, in accordance with section 6. The various factors providing guidance to the Commission for approving or rejecting a combination are given under section 20(4) of the Competition Act and includes factors such as, extent of barriers to entry, the extent of countervailing power present in the market, market share of the enterprise, the presence of substitutes, etc. The notifications are handled with reference to Procedure in Regard to the Transaction of Business Relating to Combinations Regulations

2011. Within 210 days after the notification of the proposed combination gets served, the CCI performs analysis if the combination causes or is likely to cause an appreciable adverse effect on competition (AAEC) which is done based on the factors enlisted under section 20(4) of the Competition Act.⁵⁸ The commission can approve⁵⁹ a combination to take effect if found not to be causing an AAEC or disallow⁶⁰ otherwise.

The assessment of significant AAEC that may arise as a result of a combination and the subsequent decision in case of the former can also be assuaged by remedies or notifications, termed as ‘modifications.’⁶¹ Under the Act, modifications may be suggested by the CCI⁶² or the parties, who can also propose changes to the suggested modifications⁶³ in order to bring about a mutually workable feature within the specified time. Merger modifications rather than outright rejections is slowly gaining momentum for resolving combination issues threatening to disturb the status quo in the market framework.⁶⁴

For instance, in *Abbott Laboratories & St. Jude Medical, Inc.*, a proposed combination was notified to the CCI under section 6(2) of the Competition Act, 2002 between Abbott laboratories and St. Jude Medical, Inc (SJM). Abbott dealt in manufacture, sale and research of global healthcare products. SJM, on the other hand, is a global medical device company in the United States, engaged in the production, development and research of cardiovascular medical devices. It was observed that the functions of both the parties intersected in the manufacture of ‘small hole’ VCDs (VCDs are healthcare devices used in covering the holes arising out of the arteries). As a result of the combination, the market share of the combined entity would be elevated to around 90-100 percent in the small hole segment, and the other active competitor would only have a market share of 5 percent. The entities proposed a voluntary modification by agreeing to engage in a divestiture involving the small hole VCD segment of SJM to Terumo Corporation, a third-party provider of cardiovascular products based in Japan not having any structural or financial linkages with the parties on a world-wide scale, and this was approved by the CCI.⁶⁵

Also, one of the recent developments in the area of combinations is the advent of ‘green channel’ for combinations that are unlikely to have any anti-competitive effects in the relevant market. The merging parties, based on their self-assessment, specified criteria and subsequent consultation with the Commission may qualify for green channel and, after notifying the CCI may consummate their combination through an automatic approval, whereby they may avoid the 210-day statutory standstill period.⁶⁶ An example for a transaction that has taken the green channel route is the acquisition of *Dodla Dairy Limited* (Dodla), a public limited company engaged in sale and processing of milk and milk products, by, *Industrial Finance Corporation* (IFC), a multilateral finance institution, under sec 6(2) read with sec 5(a)(i)(A) of the Competition Act. Since the proposed combination was not likely to result in any AAEC concerns, the relevant market definition was kept open. After ensuring that the acquirer was not engaged in any activities of production, distribution etc. which were similar to that of the target, the combination was given a go-ahead under the green channel route.

Interestingly, when it comes to digital platforms, the conventional methods employed to assess anti-competitive effects may fall short. With the advent of Big Data, strong network effects and the significance of personal data in the digital ecosystems, relying on traditional thresholds for gauging market power

may not yield fruitful results. Different jurisdictions have opened up investigations to ensure that dominant online platforms do not engage in anti-competitive practices. The European Commission had initiated a formal antitrust investigation to unearth if Amazon's utilization of sensitive data obtained from independent retailers doing business in its marketplace is in contravention of EU competition rules.⁶⁷ The CCI, has also acknowledged the dual role played by data as an input and as a currency for monetizing services while investigating abuse of dominance and combination cases.⁶⁸ In ***Re Updated Terms of Service and Privacy Policy for WhatsApp Users and WhatsApp LLC & Facebook***, the CCI stated that factors such as, innovation, customer service and quality have been elevated as non-price parameters of competition on the basis of which market participants compete.⁶⁹ Recently, a probe conducted by CCI found tech giant Google guilty of stifling competition and engaging in practices leading to denial of market access to extend its dominance in services such as, browser, search, app library among others for ensuring that its services serve as default options for achieving highest user preference.⁷⁰ There have been calls in multiple jurisdictions to revisit the traditional thresholds in accordance with challenges posed in the digital markets.⁷¹ The Competition Law Review Committee has also recommended inclusion of data deals as one of the thresholds to be employed during merger control.⁷²

13.12 ENFORCEMENT OF COMPETITION LAW

The Competition Act also provides a multi-tiered enforcement mechanism. As per the provisions of the Competition Act, the Commission can inquire into any alleged infringement of Section 3(1) or Section 4(1) of the Competition Act, based on its own motion or on the receipt of any information or, by a reference received from the Central Government, State Government or any statutory authority.⁷³ Under the statute, there is no *locus standi* requirement. The CCI, after the receipt of the information, is expected to satisfy itself as to the existence of a *prima facie* case, and pass directions to the Director General under Section 26(1) for initiating investigation.⁷⁴

Director-General:

The Director General or the DG, is duty bound to assist the Commission whilst conducting investigation for infringement of any provisions, rules or regulations made under the Competition Act, for which the DG shall be empowered with all the powers that are conferred on the Commission by the Act.⁷⁵ Where the Commission considers that a *prima facie* case exists, it directs the DG to investigate the matter. In ***Excel Crop Care Limited v. Competition Commission of India & Another***, the Supreme Court held that an investigation by the DG must cover all the relevant facts and evidence in order to assess any anti-competitive conduct complained of. The Court held that the “*the starting point of the inquiry would be the allegations contained in the complaint but during the course of the investigation if other facts also get revealed and are brought to light, the DG would be well within his powers to include those as well in his report*”.⁷⁶

Competition Commission of India (CCI):

The Director General shall, after conducting investigation, submit his findings to the Commission. The Commission, based on the findings of the DG may either

choose to close the matter and pass such orders as it deems fit (if no contravention of the provision of the Act is found) or, call for further investigation if required.⁷⁷ The Competition Commission of India, being the statutory regulatory authority entrusted to promote and sustain competition in the markets in India is empowered to issue interim orders in the course of inquiry to prevent acts that may have an appreciable adverse effect on competition or culminates in abuse of dominance by a group or an enterprise.⁷⁸ The Commission also has the power to impose penalties for non-compliance with the directions of Commission and the Director General⁷⁹ and for failing to provide adequate information on combinations when sought by the CCI.⁸⁰ Aside from the power to impose penalties for omission, willful alteration or furnishing a false statement before the Commission,⁸¹ the CCI also has the power to impose lesser penalty on a person included in a cartel, provided he makes a full disclosure regarding the violations. However, it needs to be noted that this feature of imposing lesser penalty shall not be available if the investigation report pertaining to the cartel has been received from the Director General by the Commission before making of such disclosure.⁸² The CCI is also required to provide its opinion to the Government in the formulation of competition policy.⁸³

Appellate authorities:

The National Company Law Appellate Tribunal (NCLAT) has been designated as the Appellate Tribunal for handling the appeals arising from the CCI. The Appellate body has been empowered to hear and dispose of appeals against any order, direction or decision issued by the CCI. Additionally, the NCLAT has been empowered to adjudicate on claims for compensation arising from the findings of the Commission as well as passing of orders for the recovery of compensation.⁸⁴ The Appellate Tribunal, after providing parties to the appeal an opportunity of being heard, is empowered to pass orders modifying, affirming or setting aside the decision, direction or order appealed against.⁸⁵ The Appellate Tribunal need not be bound by the Code of Civil Procedure, 1908 but must conform to the principles of natural justice while conducting its procedure. The Tribunal shall be vested with all the powers that are vested in a civil court for performing its functions during the trial of suit.⁸⁶ Appeals from the Appellate Tribunal shall lie to the Supreme Court which needs to be filed within sixty days from the date of communication of the decision or order passed by the Appellate Tribunal.⁸⁷

13.13 SUMMARY

Competition law is an economic legislation of immense significance and plays an important role in managing the dynamics of the market. The provisions related to anti-competitive arguments, abuse of dominance and combinations help to ensure fair competition in the market and thereby augment consumer welfare. With the rise in online platforms and the rapid shift to e-markets, competition authorities are also forced to recognize the significance of non-price parameters of competition such as quality, innovation, privacy, etc. Ensuring fair competition in digital markets poses far more challenges for the competition enforcement authorities as compared to the traditional markets. But the dynamic character of the markets and the constant emergence of new challenges also make competition law one of the most interesting areas of law for students as well as practitioners.

13.14 SELF ASSESSMENT QUESTIONS

- 1) Competition Law facilitates in-
 - a) increasing prices
 - b) diminishing output
 - c) thwarting innovation
 - d) improving product quality
- 2) Which of the following legislation was the predecessor to the Competition Act, 2002?
 - a) Consumer Protection Act, 1986
 - b) Monopolies and Restrictive Trade Practices Act, 1969
 - c) Unfair Trade Practices Act, 1972
 - d) Companies Act, 1956
- 3) Which Committee was constituted by the Government before enacting the Competition Act, 2002?
 - a) Mahalanobis Committee
 - b) Dr. J J Irani Committee
 - c) Bhabha Committee
 - d) Raghavan Committee
- 4) Competition Commission of India (CCI) is a -
 - a) Statutory body
 - b) Administrative body
 - c) Quasi-judicial body
- 5) What are the different kinds of horizontal and vertical agreements? Explain with relevant examples.
- 6) What is meant by abuse of dominance? Mention the three important steps required in every abuse of dominance investigation.
- 7) How are mergers and combinations regulated under the Competition Act, 2002?
- 8) What do you understand by the term “Green Channel” under the Competition Act, 2002?
- 9) Write a brief note on the powers and functions of the Competition Commission of India (CCI) under the Competition Act, 2002.

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UNIT 14 CONSUMER PROTECTION LAW

Objectives

After studying this unit, you should be able to:

- Understand the Evolution of Consumer Protection
- Identify the Consumer Authorities under the Act
- Discuss the Powers of the Central Consumer Protection Authority
- Explain the Process of Filing of Complaints
- Appreciate the important provisions of Consumer Protection (E-Commerce) Rules, 2020

Structure

- 14.1 Introduction
- 14.2 The Evolution of Consumer Protection
- 14.3 Consumer Authorities under the Act
- 14.4 Process of Complaint
- 14.5 Filing of Complaints
- 14.6 Powers of the Central Consumer Protection Authority
- 14.7 Product Liability
- 14.8 E-Commerce
- 14.9 Enforcement of Orders of Forums
- 14.10 Offences & Penalties
- 14.11 Consumer Protection Councils
- 14.12 Mediation
- 14.13 Summary
- 14.14 Self Assessment Questions

14.1 INTRODUCTION

The economic growth of a country depends on consumers, and it is vital that they trust the products and services providers. In 1930, when the United States of America was facing great recession, the then President Herbert Hoover while addressing the congress had remarked, “*Economic depression cannot be cured by legislative action or executive pronouncement. Economic wounds must be healed by the action of the cells of the economic body - the producers and consumers themselves.*” In a free economy, the substandard products / services has to be sacrificed for producers/providers of quality goods/ services which will have an overall impact on the economy.

Consumer satisfaction and taking care of consumer’s interest is in the long-term interest of businesses, as a happy customer would not only prefer purchasing the quality products/services for himself repeatedly, but would also encourage prospective customers by giving good feedback and thus, help in increasing the customer-base of business. Secondly, self-regulation in producing quality products

may protect the produces from government intervention or action which can impair and tarnish the goodwill of the business firms.

Consumer protection and empowerment attains prime importance since all human beings are consumers of goods and services and even businessmen who partake in selling of other goods and services are ultimately consumers of goods & services produced by other sellers or service providers. Business and consumer protection go hand in hand and consumer protection is as important for businessmen as for others because of long-term interest of business in consumer satisfaction.

14.2 THE EVOLUTION OF CONSUMER PROTECTION

The concept of consumer protection is not new. We find reference of the law and policies for consumer protection in Ancient Indian texts including Kautilya's Arthshastra. The modern consumer movement worldwide initiated when US President, John F. Kennedy on 15th March 1952 referred to four consumer rights in his famous speech in the US Congress. From the next year, 15th March was celebrated as World Consumer Rights Day on the initiative of Consumer International, an international consumer association (formerly known as 'Consumer Union'). It was a result of worldwide consumer movement, that in the year 1985, the United Nations adopted the Consumer Protection Guidelines and one of the mandates of these Guidelines for the signatory countries was to pass consumer protection legislations in their respective countries. India, being a signatory to the Guidelines, became the forerunner to pass the Consumer Protection Act in 1986, the very next year of adoption of the Guidelines in 1985. In fact, India is perhaps the only country where a dedicated machinery for redressal of consumer complaints has been set up.

Before the passing of the Consumer Protection Act, 1986, there were various other existing legislations to protect consumer interests including Indian Contract Act, the Sale of Goods Act, the Standards of Weights and Measures Act, the Dangerous Drugs Act, the Agricultural Produce (Grading and Marketing) Act, the Indian Standards Institution (Certification Marks) Act, the Prevention of Food Adulteration Act etc., which to some extent protected the interests of the consumers. However, a need was felt to pass the Consumer Protection Act, 1986, as the procedure of availing remedy under the above laws was very expensive, time consuming and was full of complexities.

The Consumer Protection Act, 1986, was enacted to provide for better protection of the consumers' interests and for making provision for establishment of consumer protection councils and other authorities for the settlement of consumer disputes, etc. This welfare legislation was well received as a boon by Indian consumers and the working of the consumer dispute redressal agencies has served the purpose to a considerable extent under the said Act. To provide a speedier remedy over ordinary civil courts, the 1986 Act, included a fixed period of time for disposal of consumer disputes. However, it was found that the cases were rarely decided within the period given in the Act. The process in the consumer forums established under the Act was intended to be summary in nature which does not include any intricacies as involved in a Civil Court and free of complexities of ordinary civil courts. However, these forums have

ended up to become civil courts full of complexities when forums have started pressing for voluminous evidence and arguments primarily due to the presence of lawyers defending the companies which forced the consumers/complainant too to hire lawyers for his case. In some cases, forums referred the parties to mediation under the provisions of Civil Procedure Code, 1908 (CPC), however such cases were very less in number. Besides, there were several shortcomings noticed while administering the various provisions of the said Act.

Consumer markets for goods and services also have undergone drastic transformation since the enactment of the Consumer Protection Act in 1986. The modern marketplace contains a plethora of products and services. The emergence of global supply chains, rise in international trade and the rapid development of e-commerce have led to new delivery systems for goods and services and have provided new options and opportunities for consumers. Equally, this has rendered consumers vulnerable to new forms of unfair trade and unethical business practices. Misleading advertisements, tele-marketing, multi-level marketing, direct selling and e-commerce pose new challenges to consumer protection, requiring appropriate and swift executive interventions to prevent consumer detriment. Therefore, it became inevitable to amend the Act to address the myriad and constantly emerging vulnerabilities of the consumers.

In view of the above, it was deemed expedient to repeal the *extant* law and enact a new law, namely, the Consumer Protection Act, 2019, which was eventually notified on 20th July 2020.

The provisions of the new Consumer Protection Act (the 2019 Act) will have an impact of revolutionising the Indian justice delivery system in the consumer cases.

Now let's discuss the provisions of the consumer legislation by focussing on the new features of Consumer Protection Act, 2019. The case laws under the Consumer Protection Act, 1986 are still applicable and will be discussed wherever needed.

The Consumer Protection Act, 2019 is really comprehensive and added various new features in comparison to the erstwhile regime *i.e.* the Consumer Protection Act, 1986. As, all the features cannot be analysed in this unit, only the main provisions are covered with special focus on newly added provisions. Let us discuss the new Act now while focussing on the following topics:

- Consumer Authorities under the Act
- Who Can file a case? Definition of Consumer
- Process of Filing Complaint & Online Complaint
- Mediation under the Consumer Protection Act, 2019
- E-Commerce: Issues and Challenges
- Product Liability under the Consumer Protection Act, 2019
- Central Consumer Protection Authority
- Offences and Penalties

14.3 CONSUMER AUTHORITIES UNDER THE ACT

The Consumer Protection Act, 2019 (“the 2019 Act”) provides for four types of entities/ authorities, which are as under:

- Consumer Protection Councils (Sections 3-9) (this was also there in the old Act);
- Central Consumer Protection Authority (Sections 10-27) (for protection of rights of common consumers & to deal with misleading advertisements and unfair trade practices);
- Consumer Disputes Redressal Commissions (Sections 28-73);
- Mediation Cells (Sections 74-81).

Three-Tiered System of Consumer Agencies (Consumer Disputes Redressal Commissions)

For adjudication of consumer disputes, *there are consumer authorities established at District, State, and Centre level*. These authorities/ forums provide an alternative remedy and have not taken away the jurisdiction of the civil courts. The consumer forums have been vested with certain powers of a civil court for adjudication of disputes. Some additional powers for ordering search and seizure have also been conferred. The commissions have the powers of a Judicial Magistrate of first class for the trial of offences of non-compliance of their orders (which may extend to 3 years). The above powers are vested with all the commissions irrespective of their hierarchy. The chart depicts different jurisdictions of consumer forums.

State Commission	1 cr – 10 cr
National Commission	above 10 cr

National Commission	Original, Review, Revision & Appellate (SCDRC & CCPA)
State Commission	Original, Review, Revision & Appellate Jurisdiction
District Commission	Original & Review Jurisdiction

District Level

Just like civil courts, the consumer agencies are established at three tiers or levels *i.e.* district, state and national level. First Tier is at District Level - District Consumer Disputes Redressal Commission (“DCDRC”). There is one DCDRC for every District in a State; DCDRC consists of President and at least two Members; The number of members in a DCDRC can go upto 10 Members. President in DCDRC can be a person who is or has been a District Judge or a person who is qualified to be a district Judge, whereas a member in DCDRC can be a person who is not less than 35 years of age and has a Bachelor’s Degree and has 15 years of relevant experience. DCDRC must have at least one Female

Member. DCDRC can hear a Complaint when the quorum consists of President and at least one Member.

DCDRC has two jurisdictions- original and review. Under original jurisdiction it has pecuniary jurisdiction up to Rs 1 Crore which means such complaints in which the amount paid for the goods and services is less than Rs 1 Crore can be filed before the DCDRC. This provision is different from the Act of 1986 under which the jurisdiction was relating to the cases below 20 Lakhs. Increasing the jurisdiction is beneficial for consumers who had to travel to state capitals for filing their cases before the State commission in cases of more than 20 Lakhs. DCDRC has territorial jurisdiction over a place where the opposite party resides or carries on its business or has a branch office; or a place where any of the Opposite Parties reside or carry-on business or have a branch office; or a place where the cause of action has arisen; or a place where the Complainant resides or personally works for gain. The last clause *i.e.*, the complainant's place has been added by the 2019 Act which makes it really convenient to access justice at his own city. The DCDRC has also been conferred Review Jurisdiction under which it can now review its own orders on the ground of an error apparent on the face of the record.

State Level:

At the state level the State Consumer Disputes Redressal Commission ("SCDRC") has been established. There is one SCDRC for every State. Some States like Maharashtra have multiple Benches in one State. SCDRC consists of one President and not less than four Members. President of SCDRC can be a person who is or has been a Judge of a High Court. Members can be persons not less than 40 years of age and is or has been a Presiding Officer of a Court or Tribunal (only for 50% Members) or has a Bachelor's Degree and 20 years of experience in the relevant fields. SCDRC shall have at least one Female Member. SCDRC has four types of judications- original, appellate, revision and review. Under original jurisdiction it has pecuniary jurisdiction between Rs 1 Crore to 10 Crores which means such Complaints in which the amount paid for the goods and services is between Rs 1 Crore to 10 Crores can be filed before the SCDRC. Just like DCDRC, pecuniary jurisdiction of SCDRC has been increased under 2019 Act. Earlier SCDRC could entertain cases whose value was between 20 lakhs to 1 crore. Increasing jurisdiction is beneficial for consumers who had to travel to state capitals for filing their cases before the State commission in cases of more than 20 Lakhs. SCDRC has territorial jurisdiction over the territory of the whole state *i.e.* all cases of the state may be filed before SCDRC subject to pecuniary value of goods or services. The SCDRC also has to power to entertain appeals from orders of all DCDRCs of the State in which SCDRC is situated. Just like the DCDRC, the SCDRC has also been conferred the Review Jurisdiction under the 2019 Act. SCDRC also has power of revision of orders of DCDRCs on limited grounds of error of jurisdiction. SCDRC may also transfer cases from one DCDRC to another DCDRC but within the State. Such transfer orders can be passed on the grounds like where any person in the quorum has any conflict of interest or where multiple cases are pending against an entity in various DCDRCs under the State.

National Level:

At the apex or national level is the National Consumer Disputes Redressal Commission ("NCDRC"). There is one NCDRC in the Country situated in the national capital *i.e.* New Delhi. NCDRC consists of one President and not less

than four Members. President of NCDRC can be a person who is or has been a Judge of the Supreme Court; or has been a Chief Justice of any High Court; or has held the post of Member or Judicial Member for a period of three years; or has an experience of twenty-five years in relevant fields. The members of NCDRC can be persons who are or have been a Judge of a High Court or is or has been District Judge or Additional District Judge for a period of ten years or have Bachelor's Degree and twenty-five years of experience in the relevant fields.

Just like the SCDRC, the NCDRC also has four types of judications- original, appellate, revision and review. Under original jurisdiction it has pecuniary jurisdiction over complaints in which the amount paid for the goods and services is more than 10 Crores. The pecuniary jurisdiction of NCDRC has been increased which earlier was Rs. 1 Crore and above. Increasing jurisdiction would reduce the pressure on NCDRC as most cases would be filed before DCDRCs & SCDRCs. The NCDRC has power to entertain appeals from orders of all SCDRCs. Just like the DCDRC & SCDRC, the NCDRC also has power to Review its orders. NCDRC also has power of Revision of orders of SCDRCs on limited grounds of error of jurisdiction. NCDRC may have circuit benches in different States. NCDRC also has the power to transfer complaints pending before one DCDRC of one State to DCDRC of another State or before one SCDRC to another SCDRC (Section 62). NCDRC also has administrative control over all the SCDRCs. under the Act of 2019, a second appeal on substantial questions of law may be filed before NCDRC (1ST appeal heard by the SCDRC).

SYSTEM OF APPEALS
Supreme Court First Appeal from National Commission (within 30 days from the date of the order)
National Commission First Appeal from State Commission (within 30 days from the date of order) Second Appeal from State Commission [from any order passed in appeal by any State Commission] [only on substantial questions of law- within 30 days from the date of the order]
State Commission First Appeal from District Commission (within 30 days from the date of order)
District Commission

14.4 PROCESS OF COMPLAINT

Section 2(5) of the 2019 Act defines “*complainant*” as —(i) a consumer; or (ii) any voluntary consumer association registered under any law for the time being in force; (iii) the Central Government or any State Government; or (iv) the *Central Consumer Protection Authority* (CCPA); or (v) one or more consumers, where

there are numerous consumers having the same interest; or (vi) in case of death of a consumer, his legal heir or legal representative; or (vii) *in case of a consumer being a minor, his parent or legal guardian.*

Definition of Consumer

“Consumer” means any person who buys any goods or hires services for a consideration and includes any user of such goods with the approval of buyer. But if goods are bought or service are hired for resale or for any commercial purpose the case falls outside the Act. It has also been made clear that if a person used the goods bought exclusively for the purpose of earning his livelihood, by means of self-employment, s/he is still a consumer and may avail the remedy under the Act. The new Act also includes *online transactions through electronic means or by teleshopping or direct selling or multi-level marketing* under it.

Section 2(6) contains the definition of “complaint” which means any allegation in writing, made by a complainant for obtaining any relief provided by or under this Act, that:

- i) an *unfair contract* or unfair trade practice or a restrictive trade practice has been adopted by any trader or service provider;
- ii) the goods bought by him or agreed to be bought by him suffer from one or more defects;
- iii) the services hired or availed of or agreed to be hired or availed of by him suffer from any deficiency;
- iv) a trader or a service provider, as the case may be, has charged for the goods or for the services mentioned in the complaint, a price in excess of the price—
(a) fixed by or under any law for the time being in force; or (b) displayed on the goods or any package containing such goods; or (c) displayed on the price list exhibited by him by or under any law for the time being in force; or (d) agreed between the parties;
- v) the goods, which are hazardous to life and safety when used, are being offered for sale to the public—(a) in contravention of standards relating to safety of such goods as required to be complied with, by or under any law for the time being in force; (b) where the trader knows that the goods so offered are unsafe to the public;
- vi) the services which are hazardous or likely to be hazardous to life and safety of the public when used, are being offered by a person who provides any service and who knows it to be injurious to life and safety;
- vii) a claim for product liability action lies against the product manufacturer, product seller or product service provider, as the case may be.” As noted above, *unfair contract* has also been included in definition of complaint.

14.5 FILING OF COMPLAINTS

Complaint containing the relevant facts and with supporting documents need to be filed before the commission of competent jurisdiction in writing.

The new 2012, Act, provides for online complaints. Complaints can be filed online on <http://edaakhil.nic.in/>. The system of online complaints is being

streamlined throughout the country. However, currently, not all Commissions have this option. There is a fee prescribed for filing complaints under Rules but there is no fee payable if the value of goods and services paid as consideration amount is less than rupees five lakhs.

Procedure to be followed at the time of and after the Complaint:

There must be a written complaint filed by the complainant alongwith relevant evidence like receipts, etc. After filing the complaint, there is an admission hearing and if admitted, a notice is directed to be issued to the opposite party. If the admissibility of the complaint not decided within 21 days, the complaint will be deemed to be admitted. The opposite party needs to file its reply within 45 days and the said 45 days cannot be extended by the Commission. The reply is then followed by a rejoinder and evidence. Thereafter, final arguments are heard and if felt necessary the Commission can seek an expert opinion in the matter and even testing of goods can be ordered by the Commission.

Limitation for Filing Complaint:

The period within which a Complaint is required to be filed before the Commission is two years from the date on which the cause of action has arisen. However, a complaint may be entertained after the said period, if the complainant satisfies the Commission that he had sufficient cause for not filing the complaint within such period and if such a complaint is entertained by the Commission, then reasons for condoning such delay need to be recorded.

Reliefs that Can Be Granted & Execution of Orders:

The following reliefs can be passed by the Consumer forums:

- Removal of defects or deficiencies in the services;
- Replacement of the goods;
- refund of the price paid;
- Award of compensation for the loss or injury suffered (may also award punitive damages);
- Discontinue and not to repeat unfair trade practice or restrictive trade practice;
- To withdraw hazardous goods from being offered for sale;
- To cease manufacture of hazardous goods and desist from offering services which are hazardous in nature;
- If the loss or injury has been suffered by a large number of consumers who are not identifiable conveniently, to pay such sum (not less than 5% of the value of such defective goods or services provided) which shall be determined by the forum;
- To issue corrective advertisement to neutralize the effect of misleading advertisement;
- To cease and desist from issuing any misleading advertisement
- To provide adequate costs to parties

As noted above some new types of orders may be passed by consumer for a under the 2019 Act which will improve effectiveness of the Act particularly in the area of misleading advertisements, the order against erring company or

individual to issue a corrective advertisement in case misleading advertisement to neutralize the effect at their cost is will prove effective to curb the menace of misleading advertisement.

14.6 POWERS OF THE CENTRAL CONSUMER PROTECTION AUTHORITY

A landmark feature of the 2019 Act is the provision for establishment of a new authority *i.e.*, Central Consumer Protection Authority for protecting, promoting & enforcing rights of consumers as a class and for regulating matters relating to violation of rights of consumers, unfair trade practices and false or misleading advertisements which are prejudicial to the interests of public. The Authority has been established in the year 2020 with its office in the capital of India and has started its activities of consumer welfare. It has its own investigation wing which can investigate instances of violations of consumer rights. For the purpose of filing any complaint, consumers can directly approach the Central Authority, or any of its appointed officers for this purpose. Complaint can also be filed before district magistrate. The CCPA can also refer matters for investigation to other regulators such as SEBI.

Under the Act, the CCPA has the power to inquire or cause an inquiry to be made into a matter of violation of consumer rights or unfair trade practices, *suo moto* or on receiving a complaint or on being asked by the central government. It can also file complaints before appropriate forums to enforce rights of consumers. CCPA is listed under the Act as a complainant. In matters relating to consumer rights, the CCPA can intervene in any pending case before any forums or review the prevailing safeguards and recommend changes. The Authority can recommend to the government, the adoption of international covenants to protect the rights of consumers.

The CCPA also has mandate to promote research into consumer rights and raise awareness about consumer rights at the ground level. It can also team up with NGOs and encourage them to work with consumer protection agencies. It can mandate the use of identifiers on goods to protect consumer rights. It can warn consumers against hazardous goods and services by issuing notices and alerts. It can advise the central and state governments and can issue necessary guidelines to prevent unfair trade practices and protect consumer rights.

During the course of the investigation, the investigator has the power of search and seizure under the Act. It follows the provisions for search and seizure as given in the Code of Criminal Procedure 1973.

Where after investigation, the CCPA is convinced that consumer rights have been violated, it can order recalling of goods or withdrawal of services, reimbursement of the cost of goods and services, and discontinuation of unfair trade practices. In cases of misleading advertisement, it can also order for any advertisement to be withdrawn or modified. It can also impose a penalty on advertisers which may extend up to 10 lakhs or up to 50 lakhs in case of repeat contravention. This penalty can also be issued on endorsers such as celebrities also, provided they did not do due diligence before endorsing the product. It can also impose a ban on the endorser from endorsing any product for up to 1 year, or up to 3 years in case of a repeat contravention. However, in all these cases, it shall give the other party an opportunity of being heard before imposing penalty.

The Central Government, and the State Governments have been conferred with the power to make Rules under the Act, whereas the NCDRC & CCPA can make regulations under the 2019 Act. Orders passed by the Central Authority may be challenged in appeal to the National Commission within a period of thirty days from the date of receipt of such order.

14.7 PRODUCT LIABILITY

The Act of 2019 provides a new provision of Product Liability which will be applicable to all cases where harm has been caused due to a defective product. The Act defines “harm” as including personal injury, mental agony and emotional distress occurring as a result of a personal injury.

Under this provision, a complainant can bring an action for product liability against a manufacturer or a product service provider or a product seller. A manufacturer can be made liable if the product has a manufacturing defect or when the product is defective in design. Manufacturers will also be liable if there is a deviation from manufacturing specifications or when they do not conform to the warranty or if the product does not contain proper instructions for correct usage to prevent harm. It is clarified under the Act that liability is not contingent on the presence of fault on the part of the manufacturer.

The product/service provider is liable in case of imperfect, deficient, or inadequate service, negligence or conscious withholding of information that caused harm, not issuing adequate warnings, non-conformity with warranty. The product sellers will also be liable if they had substantial control over the designing, testing, manufacturing, packaging or labelling of the product, they alter or modify the product and this was a substantial factor in causing the harm, the seller has made an express warranty for the product, the identity of product manufacturer is not known or they are not within the jurisdiction of India, they did not properly assemble, inspect or maintain the product or did not pass on information about the correct use of the product from the manufacturer to the consumer. The product liability provision also provides exception from liability to product seller in case the product was misused, altered, or modified, by the consumer.

14.8 E-COMMERCE

The new consumer protection regime under 2019 Act covers all modes of transactions offline, online through electronic means, teleshopping, direct selling or multi-level marketing.

To regulate the E-commerce sector in India and protect consumers from unfair trade practices in e-commerce, ***Consumer Protection (E-Commerce) Rules, 2020***, were passed which came into effect from 23 July 2020. These rules put a lot of duties on e-commerce entities in the interest of consumers.

Applicability of the Rules:

The Consumer Protection (E-Commerce) Rules, 2020, are applicable to the following:

- a) These rules apply to all goods and services bought or sold over digital or electronic network including digital products;

- b) all models of e-commerce, including marketplace and inventory models of e-commerce;
- c) all e-commerce retail, including multi-channel single brand retailers and single brand retailers in single or multiple formats; and
- d) all forms of unfair trade practices across all models of e-commerce.

However, these rules shall not apply to any activity of a natural person carried out in a personal capacity not being part of any professional or commercial activity undertaken on a regular or systematic basis. As provided under the Act, these rules shall apply to a multinational e-commerce entity offering goods or services to consumers in India.

Duties of e-Commerce Entities:

Some of the duties of e-commerce entities are:

- As per the Rules an e-commerce entity be a company incorporated under Indian Companies Act, 1956/2013 or a foreign company covered under clause (42) of section 2 of the Companies Act, 2013 or an office, branch or agency outside India owned or controlled by a person resident in India as provided in sub-clause (iii) of clause (v) of section 2 of the Foreign Exchange Management Act, 1999, needs to appoint a nodal person of contact or an alternate senior designated functionary who is resident in India, to ensure compliance with the provisions of the Act or the rules made thereunder.
- Every e-commerce entity shall provide the following information in a clear and accessible manner on its platform, displayed prominently to its users:—
 - i) legal name of the e-commerce entity;
 - ii) principal geographic address of its headquarters and all branches;
 - iii) name and details of its website; and
 - iv) contact details like e-mail address, fax, landline and mobile numbers of customer care as well as of grievance officer.
- No e-commerce entity shall adopt any unfair trade practice, whether in the course of business on its platform or otherwise.
- Every e-commerce entity shall establish an adequate grievance redressal mechanism having regard to the number of grievances ordinarily received by such entity from India, and shall appoint a grievance officer for consumer grievance redressal, and shall display the name, contact details, and designation of such officer on its platform.
- Every e-commerce entity shall ensure that the grievance officer referred to in sub-rule (4) acknowledges the receipt of any consumer complaint within forty-eight hours and redresses the complaint within one month from the date of receipt of the complaint.
- Where an e-commerce entity offers imported goods or services for sale, it shall mention the name and details of the importer from whom it has purchased such goods or services, or who may be a seller on its platform.
- Every e-commerce entity shall endeavour on a best effort basis to become a partner in the convergence process of the National Consumer Helpline of the Central Government.

- No e-commerce entity shall impose cancellation charges on consumers cancelling after confirming.
- Purchase unless similar charges are also borne by the e-commerce entity, if they cancel the purchase order unilaterally for any reason.
- Every e-commerce entity shall only record the consent of a consumer for the purchase of any good or service offered on its platform where such consent is expressed through an explicit and affirmative action, and no such entity shall record such consent automatically, including in the form of pre-ticked checkboxes.
- Every e-commerce entity shall affect all payments towards accepted refund requests of the consumers as prescribed by the Reserve Bank of India or any other competent authority under any law for the time being in force, within a reasonable period of time, or as prescribed under applicable laws.
- No e-commerce entity shall—
 - a) manipulate the price of the goods or services offered on its platform in such a manner as to gain unreasonable profit by imposing on consumers any unjustified price having regard to the prevailing market conditions, the essential nature of the good or service, any extraordinary circumstances under which the good or service is offered, and any other relevant consideration in determining whether the price charged is justified;
 - b) discriminate between consumers of the same class or make any arbitrary classification of consumers affecting their rights under the Act.

Liabilities of Marketplace E-Commerce Entities:

A marketplace e-commerce entity which seeks to avail the exemption from liability under sub-section (1) of section 79 of the Information Technology Act, 2000 shall comply with sub-sections (2) and (3) of that section, including the provisions of the Information Technology (Intermediary Guidelines) Rules, 2011.

- Every marketplace e-commerce entity shall require sellers through an undertaking to ensure that descriptions, images, and other content pertaining to goods or services on their platform is accurate and corresponds directly with the appearance, nature, quality, purpose and other general features of such good or service.
- Every marketplace e-commerce entity shall provide the following information in a clear and accessible manner, displayed prominently to its users at the appropriate place on its platform:
 - a) details about the sellers offering goods and services, including the name of their business, whether registered or not, their geographic address, customer care number, any rating or other aggregated feedback about such seller, and any other information necessary for enabling consumers to make informed decisions at the pre-purchase stage.

Provided that a marketplace e-commerce entity shall, on a request in writing made by a consumer after the purchase of any goods or services on its platform by such consumer, provide him with information regarding the seller from which such consumer has made such purchase,

including the principal geographic address of its headquarters and all branches, name and details of its website, its email address and any other information necessary for communication with the seller for effective dispute resolution;

- b) a ticket number for each complaint lodged through which the consumer can track the status of the complaint;
- c) information relating to return, refund, exchange, warranty and guarantee, delivery and shipment, modes of payment, and grievance redressal mechanism, and any other similar information which may be required by consumers to make informed decisions;
- d) information on available payment methods, the security of those payment methods, any fees or charges payable by users, the procedure to cancel regular payments under those methods, charge-back options, if any, and the contact information of the relevant payment service provider;
 - i) all information provided to it by sellers under sub-rule (5) of rule 6; and
 - ii) an explanation of the main parameters which, individually or collectively, are most significant in determining the ranking of goods or sellers on its platform and the relative importance of those main parameters through an easily and publicly available description drafted in plain and intelligible language.
- Every marketplace e-commerce entity shall include in its terms and conditions generally governing its relationship with sellers on its platform, a description of any differentiated treatment which it gives or might give between goods or services or sellers of the same category.
- Every marketplace e-commerce entity shall take reasonable efforts to maintain a record of relevant information allowing for the identification of all sellers who have repeatedly offered goods or services that have previously been removed or access to which has previously been disabled under the Copyright Act, 1957, the Trade Marks Act, 1999, or the Information Technology Act, 2000.

Provided that no such e-commerce entity shall be required to terminate the access of such seller to its platform pursuant to this sub-rule but may do so on a voluntary basis.

Duties of sellers on marketplace:

The following duties of sellers on marketplace are mentioned under the E-Commerce (Consumer Protection) Rules, 2020:

- No seller offering goods or services through a marketplace e-commerce entity shall adopt any unfair trade practice whether in the course of the offer on the e-commerce entity's platform or otherwise.
- No such seller shall falsely represent itself as a consumer and post reviews about goods or services or misrepresent the quality or the features of any goods or services.

- No seller offering goods or services through a marketplace e-commerce entity shall refuse to take back goods, or withdraw or discontinue services purchased or agreed to be purchased, or refuse to refund consideration, if paid, if such goods or services are defective, deficient or spurious, or if the goods or services are not of the characteristics or features as advertised or as agreed to, or if such goods or services are delivered late from the stated delivery schedule.

Provided that in the case of late delivery, this sub-rule shall not be applied if such late delivery was due to force majeure.

- Any seller offering goods or services through a marketplace e-commerce entity shall:
 - a) have a prior written contract with the respective e-commerce entity in order to undertake or solicit such sale or offer;
 - b) appoint a grievance officer for consumer grievance redressal and ensure that the grievance officer acknowledges the receipt of any consumer complaint within forty-eight hours and redresses the complaint within one month from the date of receipt of the complaint;
 - c) ensure that the advertisements for marketing of goods or services are consistent with the actual characteristics, access and usage conditions of such goods or services.
 - d) provide to the e-commerce entity its legal name, principal geographic address of its headquarters and all branches, the name and details of its website, its e-mail address, customer care contact details such as fax, landline, and mobile numbers and where applicable, its GSTIN and PAN details.
- Any seller offering goods or services through a marketplace e-commerce entity shall provide the following information to the e-commerce entity to be displayed on its platform or website:
 - a) all contractual information required to be disclosed by law;
 - b) total price in single figure of any good or service, along with the breakup price for the good or service, showing all the compulsory and voluntary charges such as delivery charges, postage and handling charges, conveyance charges and the applicable tax, as applicable;
 - c) all mandatory notices and information provided by applicable laws, and the expiry date of the good being offered for sale, where applicable;
 - d) all relevant details about the goods and services offered for sale by the seller including country of origin which are necessary for enabling the consumer to make an informed decision at the pre-purchase stage;
 - e) the name and contact numbers, and designation of the grievance officer for consumer grievance redressal or for reporting any other matter;
 - f) name and details of importer, and guarantees related to the authenticity or genuineness of the imported products;
 - g) accurate information related to terms of exchange, returns, and refund including information related to costs of return shipping in a clear and accessible manner;

- h) relevant details related to delivery and shipment of such goods or services; and
- i) any relevant guarantees or warranties applicable to such goods or services.

Duties and Liabilities of Inventory E-Commerce Entities:

Following are the duties and liabilities of Inventory E-commerce Entities:

- Every inventory e-commerce entity shall provide the following information in a clear and accessible manner, displayed prominently to its users:
 - a) accurate information related to return, refund, exchange, warranty and guarantee, delivery and shipment, cost of return shipping, mode of payments, grievance redressal mechanism, and any other similar information which may be required by consumers to make informed decisions;
 - b) all mandatory notices and information required by applicable laws;
 - c) information on available payment methods, the security of those payment methods, the procedure to cancel regular payments under those methods, any fees or charges payable by users, charge back options, if any, and the contact information of the relevant payment service provider;
 - d) all contractual information required to be disclosed by law;
 - e) total price in single figure of any good or service along with the breakup price for the good or service, showing all the compulsory and voluntary charges, such as delivery charges, postage and handling charges, conveyance charges and the applicable tax; and
 - f) a ticket number for each complaint lodged, through which the consumer can track the status of their complaint.
- No inventory e-commerce entity shall falsely represent itself as a consumer and post reviews about goods and services or misrepresent the quality or the features of any goods or services.
- Every inventory e-commerce entity shall ensure that the advertisements for marketing of goods or services are consistent with the actual characteristics, access and usage conditions of such goods or services;
- No inventory e-commerce entity shall refuse to take back goods, or withdraw or discontinue services purchased or agreed to be purchased, or refuse to refund consideration, if paid, if such goods or services are defective, deficient spurious, or if the goods or services are not of the characteristics or features as advertised or as agreed to, or if such goods or services are delivered late from the stated delivery schedule.

Provided that in the case of late delivery, this sub rule shall not apply if such late delivery was due to force majeure.

- Any inventory e-commerce entity which explicitly or implicitly vouches for the authenticity of the goods or services sold by it, or guarantees that such goods or services are authentic, shall bear appropriate liability in any action related to the authenticity of such good or service.

Contravention of e-Commerce Rules:

The provisions of the Consumer Protection Act, 2019, shall apply for any violation of the provisions of these rules. Therefore, the punishments and fines provided under the Act for non-compliance of orders of consumer forums are also applicable to any violation of the provisions of these rules.

Amendment to the Rules:

The government is taking initiatives to amend the 2020 Rules to bring transparency in the e-commerce platforms and further strengthen the regulatory regime to curb the prevalent unfair trade practices. Therefore, draft of proposed amendments to the rules was put for public comments in July 2021. Prohibition of fraudulent flash sales and mis-selling, appointment of chief compliance officer/ grievance redressal officer, etc., are inter alia the key amendments proposed to the Consumer Protection (e-commerce) Rules, 2020.

14.9 ENFORCEMENT OF ORDERS OF FORUMS

After the completion of the proceedings, the successful party can apply for enforcement of the order if the party against whom the order is passed, does not comply. Every order shall be enforced by it in the same manner as if it were a decree made by a Court in a suit before it. It means that unlike the previous Act the 2019 Act gives the consumer forums the power to enforce their own orders. Earlier the parties had to file application to district collector for execution. This provision would be really useful, as under the previous law for non-compliance of order the commission may impose punishment on the defaulting party in the form of imprisonment from 1 month to 3 years or a fine from 25k to 1 lakh or with both. For exercising this function, the commissions have been given the power of judicial magistrate first class. An opportunity of being heard will be given to the party before taking any action under the above provision. There is a provision for imprisonment and fine for non-compliance of order of CCPA which will be dealt with in the next section.

14.10 OFFENCES & PENALTIES

Unlike the Act of 1986, the Act of 2019 provides for new provisions relating to offences. There is a punishment prescribed for non-compliance of order of CCPA, for false and misleading advertisement, for manufacturing or storing, selling or distributing or importing of adulterated products. An imprisonment for a term upto six months or fine upto twenty lakh rupees, or both may be imposed for non-compliance of order of CCPA. False or misleading advertisement, imprisonment upto 2 years and fine upto 10 lakh rupees which, in case of any subsequent offence, will increase to imprisonment upto 5 years and fine upto fifty lakh rupees may be imposed on manufacturer or service provider. For the first time in the history of consumer law, penalty is provided for manufacturing, for sale or storing, selling or distributing or importing of spurious goods under the Consumer Act. In case of non-compliance of orders of CCPA, the Court will take up the action only on complaint filed by the CCPA. The penalty can be upto 6 months and with fine which may extend up to 1 lakh if such act does not result in any injury to the consumer, upto one year and fine up to 3 lakh rupees if it caused injury not amounting to grievous hurt to the consumer; upto 7 years and fine up to 37 lakh rupees if it caused grievous hurt to the consumer; if such act

results in the death of a consumer, minimum imprisonment shall be 7 years, maximum imprisonment shall be for life and with fine which shall not be less than 10 lakh rupees. The Act allows for compounding of these two offences at any time before or after the proceedings has been initiated. For checks and balances, a provision for punishment of the CCPA officers in case of vexatious searches has also been included.

14.11 CONSUMER PROTECTION COUNCILS

The old provision relating to the establishment of Consumer Protection Councils at Centre, State and District levels has been kept as it is under the Act of 2019. The above bodies are mandated to review consumer related policies of the government and suggest measures for further improvements for protecting and promoting rights of the consumers. The Minister In charge of Consumer Affairs in the Centre is the Chairman of the Central Consumer Protection Council and it has other official and non-official members. The State Consumer Protection Council is headed by Minister In-charge of Consumer Affairs in the State and the District Consumer Protection Council is headed by the Collector of the District. These Councils are advisory in nature and their object is to protect the rights of the consumers enshrined under the Act.

14.12 MEDIATION

Another landmark feature of the Consumer Protection Act, 2019 is the provision of mediation for resolution of consumer cases. Cases where there is existence of elements of a settlement that may be acceptable to both the parties may be referred to mediation. For this purpose, at every commission a mediation cell will be established and trained mediators will be empanelled by the commissions.

Mediation is a process where parties to a dispute, voluntarily try and settle their dispute, amicably. It is a consensual process where the party can exit anytime, they want. The process of mediation is a closed process and is totally confidential in nature. The mediator only plays the role of a facilitator and the parties are the actual decision makers and they control the whole process unlike the courts.

If unsatisfied with the process, the parties may withdraw anytime from the process and prefer to move to court, unlike in the court system where you once started cannot easily back out. Besides, in the process of mediation, as a mediator you are more closely in conversation directly to the parties and thus in a better position to understand their concerns and provide solution accordingly. Unlike the courts, Mediation believes that the parties themselves have the capacity to solve their problems.

14.13 SUMMARY

Consumer protection and empowerment attains prime importance since all human beings are consumers of goods and services and even businessmen who partake in selling of other goods and services are ultimately consumers of goods & services produced by other sellers or service providers. Business and consumer protection go hand in hand and consumer protection is as important for businessmen as for others because of long-term interest of business in consumer satisfaction.

The concept of consumer protection is not new. We find reference of the law and policies for consumer protection in Ancient Indian texts including Kautilya's Arthashastra. The modern consumer movement worldwide initiated when US President, John F. Kennedy on 15th March 1952 referred to four consumer rights in his famous speech in the US Congress. From the next year, 15th March was celebrated as World Consumer Rights Day on the initiative of Consumer International, an international consumer association.

Before the passing of the Consumer Protection Act, 1986, there were various other existing legislations to protect consumer interests including Indian Contract Act. The Consumer Protection Act, 1986, was enacted to provide for better protection of the consumers' interests and for making provision for establishment of consumer protection councils and other authorities for the settlement of consumer disputes, etc. This Act was subsequently replaced with the Consumer Protection Act, 2019.

For adjudication of consumer disputes, there are consumer authorities established at District, State, and Centre level. These authorities/ forums provide an alternative remedy and have not taken away the jurisdiction of the civil courts. Complaint containing the relevant facts and with supporting documents need to be filed before the commission of competent jurisdiction in writing. There must be a written complaint filed by the complainant alongwith relevant evidence like receipts, etc. After filing the complaint, there is an admission hearing and if admitted, a notice is directed to be issued to the opposite party.

The new consumer protection regime under 2019 Act covers all modes of transactions offline, online through electronic means, teleshopping, direct selling or multi-level marketing.

To regulate the E-commerce sector in India and protect consumers from unfair trade practices in e-commerce, Consumer Protection (E-Commerce) Rules, 2020, were passed which came into effect from 23 July 2020. These rules put a lot of duties on e-commerce entities in the interest of consumers.

14.14 SELF ASSESSMENT QUESTIONS

- 1) What actions can be taken by the authorities in case contravention of e-Commerce Rules?
- 2) What powers have been conferred on forums for enforcement of their orders?
- 3) Discuss the duties and liabilities that are prescribed by the Consumer Protection (E-Commerce) Rules, 2020 for different e-commerce entities.
- 4) Explain the different penalties imposed by the Central Consumer Protection Authority.
- 5) What is the process of mediation under the new Act? Is Mediation binding on parties?